

Copyright 2006 by Chamber of Commerce of the United States

Library of Congress Cataloging in Publications Data Main entry under title:

# CHINA'S WTO IMPLEMENTATION AND OTHER ISSUES OF IMPORTANCE TO AMERICAN BUSINESS IN THE U.S.-CHINA COMMERCIAL RELATIONSHIP

All rights reserved. No part of this work covered by the copyrights hereon may be reproduced or copied in any form or by any means—graphic, electronic, or mechanical, including photocopying, recording, taping, or information and retrieval systems—without written permission of the publisher.

# CHINA'S WTO IMPLEMENTATION AND OTHER ISSUES OF IMPORTANCE TO AMERICAN BUSINESS IN THE U.S.-CHINA COMMERCIAL RELATIONSHIP

Price: US\$30.00 Nonmembers US\$25.00 Members

Order from International Division, U.S. Chamber of Commerce 1615 H Street, NW Washington, DC 20062-2000 Telephone: 202-463-5461

Make checks payable to U.S. Chamber of Commerce—Publications. Add appropriate sales tax for the District of Columbia, Maryland, and California.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert advice is required, the services of a competent professional person should be sought.

—From a statement of principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers and Associations.

## **US CHAMBER OF COMMERCE REPORT**

CHINA'S WTO IMPLEMENTATION AND
OTHER ISSUES OF IMPORTANCE TO AMERICAN BUSINESS
IN THE U.S.-CHINA COMMERCIAL RELATIONSHIP

Myron Brilliant, Vice President East Asia Jeremie Waterman, Director Northeast Asia

# **Table of Contents**

Introductory Statement of Staff Executives	
General Overview of U.SChina Relations	3
Key Observations	
Industrial Policy	
Intellectual Property Rights	8
Services	8
Inadequate Transparency and Overly Burdensome Requirements Investment Restrictions	
Executive Summary of Report Recommendations	
Cross-Sectoral Issues	
Intellectual Property Rights	
Newly-Emerging Industrial Policies	
Subsidies	
Government Procurement	11
Standards	
Distribution, Direct Selling, and Franchising Services	
Conformity Assessment	
Investment Restrictions	
Customs	
Sectoral Issues	
Agriculture	
Audiovisual Products	
Automotive Sector	
Aviation	
Energy	
Express Delivery Services	13
Financial Services	13
Banking and Securities	13
Insurance Services	
Medical Technology	
Pharmaceuticals	14
Publications	14
Sound Recordings	14
Telecommunications Services	

China's WTO Implementation and Other Issues of Importance to American Business in the U.SChina	
Commercial Relationship	15
Cross-Sectoral Issues	15
Intellectual Property Rights	15
Newly-Emerging Industrial Policies	23
Subsidies2	26
Government Procurement	27
Standards	29
Distribution, Direct Selling, and Franchising Services	33
Conformity Assessment	36
Investment Restrictions	37
Customs	37
Sectoral Issues	38
Agriculture	38
Audiovisual Products	<b>4</b> 0
Automotive Sector	41
Aviation	42
Energy	43
Express Delivery Services	44
Financial Services	47
Banking and Securities	48
Insurance Services	50
Medical Technology	52
Pharmaceuticals	53
Publications	55
Sound Recordings	55
Telecommunications Services	56
Conclusion	50

# **Introductory Statement of Staff Executives**

hina's economic rise has become a predominant theme of the early 21st century. The speed with which new, gleaming cities of concrete and glass seem to emerge from rice paddies and the scale of China's emerging manufacturing capacity is awe-inspiring and, at times, unsettling. The process by which one-fourth of the world's working population is becoming integrated into the global trading community, demanding both an increasing share of global resources and commanding an increasing share of the global marketplace, is an opportunity and a challenge.

Members of the U.S. Chamber of Commerce, the world's largest business federation, have played a major role in China's economic development. Our members' exports to and investment in China have helped to lift millions of Chinese citizens out of poverty and brought American values and business practices to a promising new market. Moreover, our members represent a significant customer base for Chinese companies, including those in new and emerging industries. As principal advocates for open markets with China, the U.S. Chamber of Commerce and our members are primary stakeholders in the success of China's integration into the global economy.

China has greatly benefited from the increasingly open and orderly system of international trade embodied by multilateral institutions like the World Trade Organization (WTO). Yet China's economic growth raises serious questions for the United States. The same forces of globalization that have enabled China's rise also present profound challenges to American competitiveness. These forces are having an undeniable impact on the communities across the United States in which our members and their employees live and work. The U.S. Chamber is actively pressing for reforms in the United States that would increase competitiveness at home; however, this is not simply a question of getting our own house in order. China will continue to face U.S. political scrutiny to ensure that Chinese policies do not place U.S. companies and their home communities at a competitive disadvantage.

For that reason, since 2002 the U.S. Chamber has published an annual report assessing China's efforts to fulfill and build on the commitments it made upon joining the WTO in December 2001. Drawing on conclusions reached in the United States Trade Representative's February 2006 "Top-to-Bottom Review" of U.S.-China trade relations, this year's report looks beyond questions of WTO implementation to assess broader questions of market access and treatment of our membership in China. We hope that this report will inform U.S. policymakers as they continue to press for the elimination of discriminatory trade barriers in China, and aid Chinese policymakers as they continue their progress toward fulfillment of the vision underlying China's membership in the WTO.

For our part, the U.S. Chamber remains committed to working with the People's Republic of China (PRC) government and China's private sector toward these important ends. We stand behind efforts to expand exports to China for our members and other U.S. companies, particularly small- and medium-sized enterprises. We support the judicious and transparent use of U.S. trade laws in actions against unfair imports. We will continue our leadership in industry efforts to strengthen enforcement of intellectual

property rights (IPR)—a crucial objective of our membership. We will remain active in capacity-building and educational efforts throughout China, and continue to be forceful advocates for open markets between the United States and China based on the principles of fair trade and a level playing field. We trust that this report will be a useful part of those broader efforts.

We wish to emphasize that this report draws heavily on the experiences of our broad membership, and we wish to thank the many member companies and organizations that contributed information. We offer special thanks to the co-chairs of our Asia Task Force, Amb. Richard Holwill, Vice President of Public Policy for Alticor Inc., and Sandy Kristoff, Senior Policy Advisor for New York Life, for their continued strong support of the U.S. Chamber's East Asia program and their advocacy on behalf of the broader U.S. business community. We also thank Charles Freeman, Managing Director of the China Alliance, for his valuable contribution to this report as a consultant to the U.S. Chamber.

Sincerely,

pyron billig Myron Brilliant

Vice President, East Asia

Ieremie Waterman

Director, Northeast Asia

# **General Overview of U.S.-China Relations**

he U.S.-China commercial relationship has become an important driver of global economic growth and its health is critical to businesses in both the United States and China. On the whole, the bilateral economic relationship represents a significant net positive factor for each country. The United States again ranked second among China's global trading partners in 2005, and China was still the third-largest trading partner for the United States. U.S. exports to China have grown 157 percent since 2000—over seven times faster than to any other country. While China's continued economic emergence undoubtedly presents many challenges for certain segments of the U.S. economy, these statistics underscore the opportunities that China offers to U.S. exporters, investors, and, more broadly, U.S. economic growth.

The U.S.-China trade relationship is, of course, just one part of a broader relationship that President George W. Bush has characterized as "very complex." The U.S. and PRC governments interact at increasingly high levels on diplomacy, security, energy policy, and other matters. In October 2005, U.S. Defense Secretary Rumsfeld visited China in an effort to improve U.S.-PRC military-to-military relations, and in March the two sides resumed a dialogue on human rights that was suspended by China in 2004. PRC President Hu Jintao traveled to Washington, D.C. for a summit meeting with President Bush in April 2006, and the two pledged cooperation on a wide range of issues. Cooperation on difficult security matters involving North Korea and Iran has provided a useful basis for U.S. diplomats to make progress on those issues in multilateral settings. For the most part, political and security relations between the two governments have been good in the past 12 months.

The U.S. Chamber of Commerce believes, however, that the economic and commercial relationship remains at the core of this engagement. This core must be nurtured. Concerns persist that the U.S.-China commercial relationship is unbalanced in China's favor. This manifests itself in unease over the \$202 billion trade deficit with China, frustration over China's failure to protect and enforce intellectual property rights (IPR), concern that China is manipulating its currency regime to protect Chinese exports, and the increasing apprehension about Chinese domestic and outbound investment and industrial policies in energy and other "strategic" sectors, particularly as many of these sectors in China remain closed to foreign investment by American companies.

The U.S. Chamber recognizes that the bilateral trade deficit with China in part reflects changing trade patterns with other Asian countries. In addition, bilateral trade statistics, viewed without the context of global current account statistics, are not particularly useful determinants of relative economic health. But as a source for popular alarm, the bilateral trade deficit is a powerful statistic. U.S. exports to China have been increasing at a healthy clip, and the rise in the trade deficit in large part reflects the explosion of Chinese imports. However, more needs to be done to facilitate U.S. exports, particularly those of small- and medium-sized enterprises. The Chinese government has expressed its desire to move away from export-led or investment-led growth, and toward demand-led growth. The Chamber believes that this goal provides an excellent basis for U.S. and Chinese policymakers to encourage more exports from the United States.

While the Chinese central government's stated

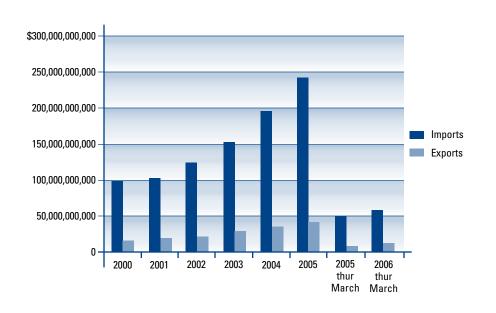
commitment to improve IPR protection and enforcement has created a basis for optimism that it will achieve progress in IPR protection and enforcement, China's failure to protect and enforce IPR remains the largest deficiency in its WTO implementation record. Without implementation of bolder measures that achieve tangible results, the Chamber is concerned that U.S. policymakers will increasingly view China's remarkable economic development as posing an unfair and serious threat to U.S. investments in research and development and economic competitiveness.

The initiative aims to promote and secure consistent and substantial progress in China's protection and enforcement of IPR by all levels of government, with a focus on provincial and local levels. Even as we expect China to significantly reduce infringing levels in the near term, the Chamber remains fundamentally committed to working constructively with PRC government at all levels, as well as with China's private sector to advance the shared goal of reducing the overwhelming levels of counterfeiting and piracy in China.

The U.S. Chamber has been supportive of China's

efforts to move toward increasing flexibility in its currency exchange rate regime.

#### U.S. Merchandise Trade with China 2000-2006



To help promote change and strengthen industry and government cooperation in the United States and China on IPR matters, in 2004 the U.S. Chamber embarked on a comprehensive China IPR initiative.

We have noted that the Renminbi (RMB) has in recent months moved higher against the dollar and that Chinese policymakers continue to stress their intention to move towards a liberalized currency policy. Continued appreciation of the RMB, in accordance with market forces, can only benefit China's economic development goals and contribute to the stability of the international financial system. We support, however, Federal Reserve Chairman Bernanke's call on China to move with greater speed toward a flexible currency; without the ability to adjust its currency in

response to international and domestic economic conditions, China lacks a fundamental monetary policy tool and cannot adequately address domestic economic challenges. Given China's increasing

## General Overview of U.S.-China Relations

integration into the global community, this continued deficiency presents heightened global economic risk to the membership of the U.S. Chamber. Concerns on this issue in the U.S. Congress and among members of the public are real; absent of demonstrable progress in the near term, this issue will almost certainly be the subject of legislation that will not be conducive to sustainable U.S.-China economic relations.

As for China's outbound investment strategy, we believe that markets are better arbiters of economic development than government plans. We strongly support the ability of Chinese companies, particularly those in China's emerging private sector, to invest in the United States and other markets. We firmly believe that an open investment environment and increasing Chinese inbound investment is in the national interest of the United States. That said, we also recognize the need for careful analysis by U.S. authorities of transactions involving access by foreign-controlled entities to strategic U.S. assets. The U.S. Chamber supports a robust, expeditious, and transparent process of oversight through the Committee on Foreign Investment in the United States (CFIUS) for such foreign investment when warranted.

Both the U.S. and Chinese governments have a clear responsibility to ensure that domestic security is not compromised through the sale of strategic assets. However, both governments must be certain that their oversight of foreign investment is undertaken without prejudice, so that concerns about security do not become proxies for protectionist interests. Equally important, the U.S. Chamber hopes that both governments will markedly increase efforts in the coming year to ensure parity in foreign investment opportunities

for U.S. companies in China; many sectors of the Chinese economy remain fully or partially closed to U.S. investors, including services, heavy industry, and biotechnology.

The 17th Joint Commission on Commerce and Trade (ICCT), held in April 2006, was an important and useful process to help manage political tensions between the two countries over commercial matters. Conducted for the third year in a row as an elevated dialogue between one of China's most able and experienced economic leaders, Vice Premier Mme. Wu Yi and her counterparts in the United States (the Secretary of Commerce and the United States Trade Representative), the JCCT has been a vehicle to resolve trade problems before they become larger irritants in the bilateral relationship. The U.S. Chamber submitted recommendations to the U.S. government on its priorities for the April 2006 JCCT and noted progress made in those meetings on some of our key issues.

However, the increasing complexity of the U.S.-China economic and commercial relationship merits a broader engagement process than is possible through the JCCT; it is increasingly unreasonable to rely on a single vice premier to resolve the multi-faceted challenges that are embedded in U.S.-China economic and commercial relations. We would thus urge both the United States and China to institutionalize meaningful dialogues across ministries and departments and expand the process of engagement to other vice premiers and cabinet officials. This would help ensure that matters under the respective oversight of such other officials are duly addressed and would also provide the necessary "buy-in" across the political spectrum in both countries.

We are pleased that China continues to demonstrate a willingness to work with the U.S. business community and government, but we need to see continued, visible, near-term progress. China needs to demonstrate its credentials as a constructive member of the global economy by promptly and fully implementing its WTO commitments and ensuring full market access.

Moreover, as China concludes its phase-in period for WTO implementation, it should expand market access that underlies and begins to go beyond the letter and spirit of its WTO commitments. The U.S. business community viewed China's WTO access as a floor, not a ceiling, for continued progress. If China falters in meeting its commitments and in increasing market access for U.S. firms, there will be political and commercial ramifications that will constrain the full potential of this relationship to the detriment of both countries.

In this environment and as we move toward year five of China's WTO commitment phase-in period, the U.S. Chamber offers a number of observations on China's implementation efforts.

# **Key Observations**

s a general matter, the participation of the U.S. Chamber and our member companies in China continues to be positive. Many U.S. businesses report satisfaction with their activities in China, including the increasing opportunities to reach the domestic Chinese consumer market.

However, the Chinese market is not without its challenges. Indeed, in some cases, the challenges in China present major concerns to the U.S. Chamber and our member companies. In producing this report, we have canvassed our membership for their concerns about doing business in China, and note the following key observations from this exercise:

## **Industrial Policy**

Over the past 12 months we have seen an upsurge in industrial planning measures as tools of economic development by central government authorities. China's leaders currently face a choice: either to narrowly interpret WTO commitments and maximize the use of government intervention to protect and nurture Chinese industries, or to apply the letter and spirit of the WTO and recommit to the broadest possible use of markets to drive innovation, job creation, and economic growth. While IPR remains the number one issue in our bilateral economic relationship (as discussed below), the continued and expanding use of government intervention and industrial policies (with their associated subsidies, investment restrictions, and other protectionist measures) have the potential to create even sharper frictions in bilateral economic relations than IPR.

This phenomenon is as puzzling as it is troubling. China's breathtaking economic successes over the past two-and-a-half decades have largely come through the embrace of market principles by the Chinese government. By removing regulatory impediments to commercial activity and allowing markets to operate with minimal state intervention, China has managed to unleash the competitive aspirations of a new generation of entrepreneurs and to establish China as a leading engine of global economic growth. The reduction of government involvement in the economy has also supported China's important anti-corruption goals.

However, in recent years Chinese industrial planners have been cranking out a series of ambitious policies aimed at stimulating growth of domestic Chinese industries by manipulating markets through government intervention. In late June 2006, the State Council issued a striking set of Opinions that identify strategic priorities for development, offer new direct subsidies in these priority areas, and actively discourage foreign participation. On top of longstanding and illdocumented subsidization of China's state sector, tax and other import substitution policies, standards policies that benefit Chinese domestic producers at the expense of competition from overseas innovators, discriminatory government procurement policies, entry-exit requirements, and policies like the proposed Anti-Monopoly Law, are the latest examples of a resurgent Chinese economic nationalism that bodes ill for both China's own economic growth and for China's integration with the global business community. These types of discriminatory policies move China in the wrong direction and, if continued, will result in a political and economic backlash.

# **Intellectual Property Rights**

The lack of more effective protection of intellectual property rights (IPR) remains the most significant area of concern with respect to China's record of implementation of its WTO commitments. Beijing is correctly articulating the long-term importance of IPR to the development of the Chinese economy and its own enterprises, and it has taken some important steps to address the theft of intellectual property. However, the scale and scope of piracy and counterfeiting remains overwhelming, and the reforms being implemented by the government under its March 2006 "Action Plan" seem insufficient to address the problem. The most serious gaps in the Action Plan are the absence of plans to substantially increase police manpower dedicated to IP enforcement and to amend the PRC Criminal Code.

Until gaps in China's criminal enforcement regime are addressed, those engaged in IP theft in China will continue to regard the current penalties which are mainly limited to administrative fines as a mere cost of doing business, and the problems will remain grave. This poses significant danger to the health and safety of Chinese consumers and China's worldwide customers as well as to the overall U.S.-China relationship.

Respect for IPR is a sine qua non of successful U.S. participation in the global economy. Continued failure to address piracy and counterfeiting at the provincial and local levels strikes at the heart of global U.S. competitiveness. This will ultimately be interpreted by many U.S. policy-makers as a signal that China's remarkable economic development actually poses serious threats to its trading partners. Needless to say, that message would be corrosive to sustaining U.S. political support for a

strong and positive relationship with China. It is essential that China realize that much bolder steps are needed to address IP theft, not only for the good of U.S. IP owners, but for the good of China's own economic and social development.

### Services

U.S. service providers have shown remarkable patience as the market opens along lines contemplated by China's WTO accession, but slow and capricious regulatory decisions, capital requirements that far exceed prudential or other global norms, structural operating rules that encourage inefficiencies, and an incomplete separation of regulatory oversight from commercial activities, make services sectors particularly troublesome from the perspective of U.S. businesses. In particular, the modernization of China's financial sector is a top priority for Chamber members and is clearly in the interest of both China and the United States. Specific steps that China should take to bolster reform of its financial markets include the following:

- Permit foreign financial services firms to own 100 percent of the operations in which they invest, and to establish in the juridical form that best suits their business model (branch, subsidiary, joint venture).
- Treat foreign investors in a non-discriminatory manner and provide national treatment in all aspects of their business including the types of services they may provide and the clients they may serve, as well as licensing and other regulatory requirements.
- Permit foreign financial service firms to supply

# **Key Observations**

services to sophisticated consumers across borders.

 Provide a transparent regulatory environment that includes administrative procedures that supply all market participants with effective notice and the opportunity to comment on proposed regulatory reforms.

Chinese officials seem particularly determined to limit access by foreign service providers in many sectors based on an apparent desire to shield domestic players from competition. Rather than benefiting China's domestic services sector, such measures retard the development of the services sector overall and deny China's consumers the most efficient service at the lowest cost. Despite the rapid increases in efficiency and economic welfare in China in recent years, China's services sector lags far behind those in more competitive markets. Service industries seem particularly susceptible to being hindered by poorly-crafted and capriciouslyimplemented regulations.

Thus, sectors as varied as financial services, distribution and logistics services, and direct-toconsumer services, are all under-developed.

Enhanced participation by U.S. firms in this marketplace would benefit the development of individual service sectors, as well as improve the productivity and efficiency of the Chinese economy. A thriving, competitive services sector will provide the employment and the efficiencies that China needs to continue to grow its economy in the long run. U.S. service providers have shown remarkable patience as the market opens along lines contemplated by China's WTO accession, but slow and capricious regulatory decisions, capital requirements that far exceed prudential or other global norms, structural operating

rules that encourage inefficiencies, and an incomplete separation of regulatory oversight from commercial activities, make these sectors particularly troublesome from the perspective of U.S. businesses.

# Inadequate Transparency and Overly **Burdensome Requirements**

Unclear regulations, excessive bureaucracy, a lack of transparency, and inconsistent regulatory interpretation remain major impediments to doing business in China. Although Chamber members acknowledge that China's regulatory environment is improving, China's WTO membership has not done nearly enough to reduce these significant operating challenges facing Chamber members. Likewise, there are myriad problems caused by uncertainties related to tax reform and the manner in which it will be applied to foreign-listed corporations. Moreover, in recent years there has been a disturbing trend toward 'outsourcing' certain government regulatory functions—such as the EDI for customs clearance—to well-connected private sector entities who use their regulatory power to extract monopoly rents from users.

Many of these regulatory obstacles are the result of bureaucratic inefficiencies that are not unique to China. However, there are a range of troublesome areas, including "Catch-22" import-licensing decisions, customs rulings on certain imports, zerotolerance quarantine policies that lack a sound scientific basis, and others that are not as easily explained. While these latter policies may not always be designed to benefit domestic Chinese interests at the expense of overseas trading partners, in most cases they have that effect, and create obvious conflicts with the WTO principle of non-discrimination.

## **Investment Restrictions**

In a range of sectors, from automotive to financial services and energy, to telecommunications and postal services, China appears to be accelerating the implementation of barriers to investment by foreign entities, including members of the Chamber. We are concerned that these restrictions, which will only retard the growth and development of the Chinese economy, are increasingly seen as protectionist tools by industrial planners to shield inefficient or monopolistic enterprises from competition. While we recognize that certain sectors may have particular sensitivity in China due to security or other concerns, the broad application of investment barriers under such auspices—including increasing restrictions on foreign acquisitions of Chinese companies—is a deeply worrisome trend and stands counter to the market-oriented principles that have been the basis for much of China's economic success over the past few decades.

# **Executive Summary of Report Recommendations**

his report addresses concerns across sectors, as well as certain sector-specific concerns, and makes a series of recommendations as follows:

## **Cross-Sectoral Issues**

## **Intellectual Property Rights**

- China should significantly reduce the level of IP infringement by adopting a wider and more aggressive array of measures. Most important among these are the need to significantly boost police resources and training for criminal enforcement, and to amend the Criminal Code and other legislation to comply with WTO obligations and other international norms.
- China should also fully implement its existing JCCT commitments on IP protection and enforcement by increasing criminal prosecutions for IP violations, increasing the accountability of local governments in protection and enforcement of IP rights, and strengthening international collaboration in all aspects of IPR protection. China's legislature should also be encouraged to remove loopholes and otherwise strengthen the PRC's Trademark Law, Copyright Law, Patent Law and other legislation in order to strengthen the deterrent impact of administrative and civil enforcement of IP rights.
- Furthermore, China should act more aggressively and proactively to deal with the newest battlefront for IP protection—the Internet. As efforts to deal with "hard" infringements in retail and wholesale markets take root, copyright piracy and trademark counterfeiting are certain to shift further to the online environment.

## **Newly-Emerging Industrial Policies**

 China should refrain from utilizing non-trade laws to impose non-tariff barriers on U.S. products or suppliers. Recently announced initiatives to promote "self-reliant innovation" by decreasing China's use of foreign technologies are worrisome to the U.S. Chamber and our members. While aspects of these proposals are unobjectionable, others are less benign. Of immediate concern to U.S. industry is ensuring that China's evolving competition laws; proposed patent law reforms; proposed standards policies, regulations and policies; and government procurement regime are nondiscriminatory and transparent and fully respect the rights of U.S. inventors and authors to protect and commercialize their innovations and works within China. The Chamber urges China to stay the course charted by its visionary leadership over the past three decades and rely on the market, not decisions by government officials, to achieve its economic goals.

### **Subsidies**

• China should provide a much more detailed report to the WTO on its use of subsidies, with particular attention to subsidies of state-owned companies provided through its banking system, provincial government-level subsidization, and the amount of subsidies involved.

#### **Government Procurement**

• China should move expeditiously to join the Government Procurement Agreement.

### **Standards**

 China should refrain from the use of mandatory or other standards not developed through the established international standard-setting process. In particular, China should embrace those standards which emerge through international market acceptance, rather than through a process by which governments establish standards by fiat.

## Distribution, Direct Selling, and Franchising Services

• China should ensure that distribution services, direct selling, and franchising services regulations adhere to the spirit and letter of its WTO (particularly with respect to national treatment obligations) and JCCT commitments and respect established international norms and practices.

## **Conformity Assessment**

 China should streamline conformity assessment practices to prevent duplicative testing, factory inspections, and customs inspections, and provide accreditation for foreign-invested conformity assessment bodies.

#### **Investment Restrictions**

• China should be cautious that new restrictions on market activity, particularly in investment, are not used to roll back decades of pro-investment policies that have formed the basis for China's economic miracle.

#### Customs

China should clarify and streamline customs

procedures to create a more uniform and transparent national customs system.

## Sectoral Issues

## Agriculture

 China should continue to search for ways to maximize its comparative advantage in agriculture and, with respect to imports, apply consistent and transparent standards in testing and in quarantine decisions on imported agricultural products, while ensuring that import licensing processes are conducted on a non-discriminatory basis.

#### **Audiovisual Products**

- China should lower or eliminate the current artificially-high criminal thresholds for the prosecution of copyright infringements, increase the number of foreign films approved for theatrical distribution on a non-bound basis, cease the imposition of arbitrary blackout periods on foreign films, abolish the theatrical import monopoly and distribution duopoly, streamline licensing for large retailers, enact an enforceable ban on the sale of audiovisual media by street vendors, adhere to its retail distribution services commitments and allow foreign majority controlled retailers to secure AV licenses and sell AV content, streamline the clearance of films and videos, and establish a film ratings system.
- China should also abide by its WTO commitment to afford foreign retailers national treatment and remove the discriminatory provision that prevents foreign-controlled retailers from obtaining retail AV licenses.

#### **Automotive Sector**

 China should revise the Measures on the Management of Parts Import Constituting an Entire Automobile literature to ensure that it is consistent with its WTO trade-related investment measures (TRIMs) commitments.

#### **Aviation**

 China should fully liberalize its aviation relationship with the United States and other major partners to allow the market to determine the number and location of international flights. China should lower exorbitant aviation fees by allowing foreign carriers to participate in aviation fee development. Foreign airlines should be able to hire Chinese staff directly.

## Energy

• China should increase the access of foreign participants in markets for trading of petroleum products in accordance with its WTO commitments.

## **Express Delivery Services**

- China should follow the dictates of its newly promulgated Administrative Licensing Law and reduce or eliminate licensing requirements for express carriers.
- China should ensure that its new postal law conforms to China's WTO obligations by providing equal access to the market for foreign and domestic players and by not rolling back any rights that express delivery service suppliers had at the time of China's accession to the WTO.

• China should comply with its WTO commitments to fully open its market for freight forwarding services by allowing wholly foreign- owned companies to provide air freight forwarding services in China.

## **Financial Services**

- Banking and Securities China should roll back restrictions on ownership of banking and securities companies in line with its continued development and liberalization of its financial sector, and eliminate inconsistent and excessive regulatory restrictions on financial service entities.
- **Insurance Services** The China Insurance Regulatory Commission (CIRC) should enhance and regularize the dialogue between Chinese and U.S. regulators, government officials, and industry. A number of issues require attention, including the timely review of applications for conversion from branch to subsidiary status in line with existing CIRC regulations, the need for greater clarity concerning internal insurance branching approval procedures, and the need to ensure national treatment with respect to consecutive versus concurrent application and approval of licenses. China should also identify the principal authority for approval of provincial licenses and allow foreign insurance companies to expand geographically according to the terms of its WTO commitments. Further, it should permit nonlife insurers to continue to expand their businesses throughout the country without any additional capitalization requirements or lengthy application processes. Building on positive steps already taken by CIRC and in light of global best practices and standards, China should also examine its existing capitalization requirements, which remain excessively high.

## **Medical Technology**

 China should increase transparency and eliminate redundancy in its regulatory processes in the medical device industry, limit the scope of price control mechanisms, and refrain from discriminatory practices that favor domestic manufacturers of digital medical imaging devices.

#### **Pharmaceuticals**

- China should make changes to its pharmaceutical pricing policy in a transparent manner with input from all relevant stakeholders, including consultation with the U.S. government. China should maintain its existing, independent review process for pharmaceutical prices.
- China should clarify the scope of products covered under China's data exclusivity regulations. The guidelines should explicitly indicate that the State Food and Drug Administration (SFDA) will not accept applications of generic drugs during the six-year exclusivity period, unless the generic producer provides a complete data package demonstrating the safety and efficacy of the drug through clinical trials.
- China should increase IPR enforcement against pharmaceutical counterfeiters, including through extending SFDA oversight to bulk chemical producers of active pharmaceutical ingredient and defining criminal counterfeiting of drugs as the "deliberate mislabeling with respect to identity or source."

#### **Publications**

• China should eliminate restrictions on the ability of foreign-invested distributors to exercise WTO-authorized trading rights and engage in WTO-permitted distribution services.

## **Sound Recordings**

 China should allow majority foreign-invested enterprises greater license to develop, create, publish, market and distribute sound recordings in China, eliminate discriminatory censorship of foreign sound recordings, and criminally prosecute copyright pirates—including those engaged in large scale optical disc manufacturing facilities.

### **Telecommunications Services**

- China should accelerate its work to separate the regulatory and commercial functions of its telecoms regulator.
- China should adopt the currently pending Telecom Law, including provisions that overhaul the license regime, replacing the current conservatively applied vertical service classification guidelines with more objective and transparent horizontal guidelines for Type I and Type II licenses that improve market access.
- China should grant equivalent national treatment to both domestic and foreign telecoms investors, consistent with its WTO commitments.

# **Cross-Sectoral Issues**

n the following section, we outline the Chamber's recommendations on key priority policies in the area of intellectual property rights (IPR), industrial policy, distribution services, direct sales, customs, franchising, and conformity assessment.

## **Intellectual Property Rights**

### Summary

The IPR climate for most of our companies in China has not significantly improved over the last year, due to the lack of adequate deterrence of intellectual property (IP) theft in the marketplace. If anything, the climate has worsened, as more and more small- and medium-sized enterprises (SMEs) complain of the dramatic impact of counterfeits on their businesses worldwide.

China issued a series of pronouncements in March 2006 and at the April 2006 meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT) about its plans to improve IPR protection and enforcement, including a series of measures set out in the government's March 8, 2006 "Action Plan" on IPR protection. There have been some positive developments since the publication of the Action Plan, including a recent crackdown on copyright piracy at the retail level, the issuance of regulations on the protection of copyright works on the Internet, regulations intended to promote the transfer of administrative enforcement cases to the police, and regulations on the protection of IP at trade exhibitions.

However, the Chinese government's plans contain a number of obvious gaps. The government has yet

to announce plans that address the biggest concerns of industry: the lack of sufficient police recourses allocated to copyright piracy and trademark counterfeiting, and the lack of plans to amend the PRC's Criminal Code with respect to IP crimes. We recognize that these particular steps will require the exercise of enormous political will within China, both by the central and local governments. However, we believe there is no other option in order for China to meet both its international obligations under the WTO and its other bilateral agreements.

To help promote change and strengthen industry and government cooperation in the United States and China, the U.S. Chamber embarked on a comprehensive China IPR initiative in 2004. The initiative aims to improve the PRC government's response and awareness of IP challenges at all levels of government, with the goal of promoting and securing consistent and substantial progress in China's protection and enforcement of IPR. This initiative includes the following key elements:

- (1) Enhancing coordination of policy messages delivered to the U.S. and Chinese governments on China IP concerns.
- (2) Providing an overarching, inclusive platform for substantive dialogue on IP-related legal and policy matters between U.S. corporate, legal, and academic IP experts and Chinese government officials at the national, provincial, and local levels.
- (3) Establishing new benchmarking initiatives at the national and provincial levels to more accurately monitor the government's performance, including effectiveness in IPR

enforcement, and responsiveness to domestic and foreign industry concerns.

- (4) Creating new joint working groups in the provinces to collaboratively identify obstacles in enforcement at the provincial and local level and to generate possible solutions.
- (5) Conducting joint enforcement seminars in Guangdong, Fujian, Jiangsu, and Zhejiang provinces to educate local stakeholders and further research important IP issues. The Chamber has conducted four seminars since July 2005, and will conduct an additional two enforcement seminars in Fujian and Zhejiang this fall.

In the year ahead, the Chamber will continue to work with all levels of the PRC government with the goal of reducing the level of counterfeiting and piracy of IPR in China. To strengthen IPR protection and enforcement, the Chamber will stimulate expert discussions on a wider range of necessary legal reforms, including reform of China's Criminal Code, introduce more international "best practices," and continue efforts to raise awareness. Furthermore, the Chamber plans to expand its program of targeted seminars with provincial authorities and initiate a broader range of cooperative projects both with individual ministries and other U.S., Chinese, and foreign industry associations.

#### **Detailed Assessment**

While significant IPR protection and enforcement efforts are underway in China, the U.S. Chamber of Commerce and its members still believe that China has fallen short of commitments to effectively protect IPR, both with respect to its obligations under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights Agreement (TRIPS Agreement), as well as China's many JCCT commitments on IPR protection and enforcement.

IPR violations in China severely affect virtually all U.S. industries in the United States and abroad, U.S. Customs seizure statistics clearly indicate that China continues to be the largest single source of counterfeit and pirated imports into the United States. In 2005, goods imported from China into the United States that were seized for IPR reasons represented 69 percent of all such goods. During the first half of 2006, total seizures at U.S. ports of counterfeit and pirated products from China increased by 21 percent to over \$34.3 million, accounting for approximately 75 percent of total seizures. 2 Increasing levels of exports of counterfeit and pirated products from Chinese companies are seriously undermining established markets for U.S. producers not only in China, but also in many other countries. Counterfeit products made in China also continue to inflict serious risks to public health and safety worldwide.<sup>3</sup>

<sup>1</sup> U.S. Customs and Border Protection. This figure measures the value of such IPR-infringing goods seized from China against the total value of such goods, and rose from 63 percent to 69 percent between 2004 and 2005. These figures are conservative, as they do not include fake products made in China that were imported from third countries or regions such as Hong Kong, and furthermore do not measure the value of IPR-infringing goods from China that are consumed in third countries.

<sup>2</sup> If seizures from Hong Kong are included, China accounted for approximately 80 percent of all seizures at U.S. ports.

The International Anti-Counterfeiting Coalition (IACC) recently noted that counterfeiting of pharmaceuticals appears to be growing to the point where many of the widely used drugs in China suffer from counterfeiting rates of 30 percent or higher. The threat to public health from counterfeiting is thus a significant concern to Chinese policy-makers. In addition to the widely reported problems associated with counterfeit pharmaceuticals and foodstuffs, the ongoing proliferation of counterfeit agricultural chemicals poses a major threat to the safety of China's food supply and to China's already overburdened environmental infrastructure.

There are signs that the central government and many regional governments are committed to dealing more proactively with counterfeiting and copyright piracy, and cooperation with industry and with IPR enforcement authorities in the United States has increased. However, increased criminal enforcement and significant reductions in the levels of piracy and counterfeiting in the market are the only true measures for determining the fulfillment of these commitments. The continuing high levels of infringement are clearly exacerbating political tensions, and play into the hands of those in the United States who are threatening to impose trade barriers on imported Chinese products.

The Chinese government took important steps between 2004 and early 2006 to improve legislation on IPR protection and at the same time moderately increased the number of criminal cases against trademark counterfeiters. 4 Recently released statistics on enforcement actions for the period between January and June 2006 suggest that police actions against pirates and counterfeiters are up, and that local Administrations for Industry & Commerce (AIC) are undertaking a high number of raids on suspected infringers of IPR. However, both the number of AIC raids and the transfers of IP cases from the administrative to the criminal system appear to be fewer than in 2005, a matter which should sound a note of concern among Chamber members and policymakers in the United States and China.

The Chinese government has also begun to introduce a range of systematic changes under its Action Plan announced March 8, 2006, which should increase transparency and accountability and provide greater hope for IPR owners seeking simpler and more effective enforcement of their rights. However, over the last ten years, the Chinese government has issued multiple action plans on IPR protection that have not been effectively implemented. The enthusiasm of international stakeholders, including the Chamber, for this latest Action Plan must therefore be tempered by experience, and it is clearly necessary for foreign industry and governments to follow up closely on all of China's commitments as well as continue engagement with relevant governments on critical areas of concern which have not been addressed in the most recent Action Plan or elsewhere.

At the April 2006 meeting of the ICCT, Vice Premier Wu Yi pledged that "IPR trial chambers will be open in courts across China" and that "50 IPR Infringement Reporting Centers will be set up in 50 key cities in China." 5 The Chinese government

Chinese government statistics suggest a 50 percent increase in arrests for IP theft from 2004 to 2005. Prosecutions during this period increased by 24 percent and criminal convictions by Chinese courts increased 28 percent, to 3,567 cases. The government's efforts to encourage more transfers of serious cases from administrative enforcement authorities to the police have not been as impressive, and indeed illustrate the depth of the problem. According to statistics issued by the State Administration for Industry and Commerce (SAIC), which is the main administrative enforcement authorities in China, only 236 cases were transferred from local AICs to the police in 2005. In Guangdong Province, which is widely regarded as the most difficult region in China for IPR violations, only 17 AIC cases were transferred to the police. Chinese police have begun making an impression on the foreign business community through success in dealing with a few high-profile cases, such as "Operation Cross Ocean," a joint effort with American authorities, which resulted in the arrest of 12 people and the seizure of \$4.3 million in fake drugs. However, such cases need to become more routine. This will of course require more proactive involvement from American law enforcement as well.

See Press Conference With U.S. Commerce Secretary Carlos Gutierrez, U.S. Secretary of Agriculture Mike Johanns, U.S. Trade Representative Rob Portman, Chinese Vice Premier Wu Yi at the Annual Meeting of the U.S.-China Joint Commission on Commerce and Trade (Apr. 11, 2006).

completed the establishment of these centers in late August 2006, and they may prove useful for IP owners that have in the past been confused as to the correct authority with which to file enforcement complaints. But it remains unclear whether these centers will have other functions, such as the job of intervening when difficulties arise in the course of administrative transfers to judicial authorities or with protectionism.

The PRC also announced at the April 2006 JCCT that it had issued a notice requiring the pre-loading of legal operating system software on all computers manufactured in or imported into China as well as a notice requiring government agencies to provide adequate budget for, and the purchase of computers with pre-loaded legal software. In line with these requirements, several Chinese computer manufacturers have recently signed agreements to purchase U.S. operating system software. These announcements build upon commitments undertaken by China at the July 2005 JCCT to complete its legalization program designed to ensure that all central, provincial, and local government offices use only licensed software, and to extend this program to enterprises (including state-owned enterprises) in 2006.

These important commitments underscore the central government's commitment to improve IPR protection and enforcement, and create a basis for optimism that the Chinese government will continue to achieve progress in IPR protection. However, because there has not been a substantial reduction in the scope and depth of the overall IPR problem over the last two years, and to ensure sustainable forward movement in areas where strong commitments have been made, more aggressive actions, especially in the areas of enforcement and transparency, are urgently needed.

The Chamber is particularly concerned that more attention be paid in three key areas:

First, a range of measures are required to strengthen criminal, administrative, and civil enforcement of IPR and to substantially increase deterrence. Criminal enforcement of copyrights, in particular, remains almost impossible. 6 Some of the obstacles to enforcement are clearly based on ambiguities and gaps in China's Criminal Code, in related judicial interpretations of the Supreme People's Court, and in other legislation. Perhaps of greater concern is the lack of resources and political priority given to criminal enforcement of IPR by local governments.8 The Chamber regards as a positive development the recent decision by the Chinese police in Shanghai to launch an investigation into a drugs counterfeiting ring on their own initiative, rather than waiting to establish that the activities of the gang met the

Despite years of enforcement efforts, including a 15-month anti-piracy campaign that ended in December 2005, piracy rates of physical copyright products in China are the highest in the world. The Intellectual Property Alliance (IIPA) estimates piracy rates in China to be 85 to 95 percent depending on the industry and product format.

In the view of many experts, the problems with the PRC Criminal Code result from a defect in Chinese criminal law theory, a lack of consideration to the realities of IP enforcement work, and insufficient appreciation for the full range of societal harm that is caused by IP infringement.

For example, while the Chinese government confirmed that criminal thresholds in the 2004 Juridical Interpretation are applicable to sound recordings, the IIPA is unaware of a single criminal copyright case in China involving sound recordings. Likewise, although exporters are subject to independent criminal liability, IIPA is unaware of a single criminal copyright case conviction for the crime of exporting pirated products.

relevant numerical threshold for criminal liability.9 Meanwhile, administrative fines remain a mere cost of doing business for most infringers, and the compensation issued in most civil cases remains insufficient to cover the legal fees and investigation expenses of right holders, let alone compensate for the injury suffered.

Second, we believe additional measures to permit transparent monitoring and verification of enforcement efforts and their impact are needed, especially at provincial and local levels. Timelier issuance of detailed enforcement statistics and greater publication of enforcement efforts will help to deter offenders and identify areas where enforcement is still lacking. 10 The Chamber will continue to commit resources to work with provincial and local governments to benchmark progress and to improve transparency of enforcement statistics. We also hope that the central government will provide provincial and local governments with even clearer guidance, legal mandates, and resources to enforce the IPR of foreign and domestic stakeholders. Moreover, enforcement authorities, including those responsible for copyright, should be required to provide copies of decisions issued following the handling of administrative actions, whether based on the complaint of the IPR owner or the government's own ex-officio actions. 11

Third, it is vital that the PRC government commit the funds necessary to fulfill its recent JCCT commitments. For instance, Chinese government agencies as a practical matter will be able to honor China's software government legalization commitments only if they are given the funds necessary to purchase legal software (rather than copy pirated software). Clearly, if China does commit such funds, it will need to ensure that local and provincial entities actually expend such funds toward legal software, so budgeting will have to be managed carefully. Similarly, government agencies must be given the training and tools necessary to manage their software assets and prevent illegal software from finding its way onto government computers. The PRC government should also commit IPR enforcement resources to ensure that computer manufacturers and distributors in China do in fact pre-install all PCs they sell with legal software.

Thus, even as China committed to a variety of policy changes on IPR at the ICCT meetings in 2004, 2005, and 2006, the implementation of these commitments has been mixed, and IPR infringement remains at epidemic levels. For example, new

In April this year, following sustained lobbying from groups like the QBPC, the Ministry of Public Security approved the so-called Shanghai Initiative, which gives the green light to the police to launch criminal investigations into allegations of counterfeiting on their own initiative, based on suspicious leads.

<sup>10</sup> For example, as noted by the IACC, while the Ministry of Public Security has reported promising statistics on criminal enforcement of IP, indicating number of cases handled, prosecutions of persons for IP crimes, and criminal court cases accepted, the statistics are not broken down by the nature of the IPR infringed upon or the region in which enforcement action was taken. Moreover, published statistics do not indicate whether the arrests and convictions include cases for Criminal Code violations that do not directly relate to intellectual property.

<sup>11</sup> In accordance with the March 8, 2006 Action Plan, the Ministry of Public Security issued four sets of regulations in early 2006 to promote the transfer of administrative cases to the police. Such regulations have previously been issued in 2001 and 2004, but with limited effect, and it remains to be seen whether the new regulations will achieve their stated objectives of increasing transparency and promoting cooperation and accountability among relevant authorities. Ultimately, responsibility for successful transfers rests with Chinese prosecutors, who will need to monitor case transfers more closely than in the past.

Internet regulations have been issued to protect IPR in the digital environment, but concerns remain regarding the scope of the rights protected by the new law and vague terminology in the law that could result in significant loopholes. An effective Internet law is critically important given the rapid uptake of broadband in China, the increase in Internet piracy, and the fact that all P-2-P web sites streaming broadcast content without authority are headquartered in China. The Chamber hopes that China will fulfill all of its JCCT commitments, both to the letter and in spirit.

The Chamber therefore asks that China's leadership take bolder and more effective measures to generate tangible results that will lead to true deterrence and a substantial decrease in IPR infringement, with particular attention to the level of trademark counterfeiting and copyright piracy. This will require allocation of substantially greater enforcement resources at the local levels—particularly in hotspots such as Guangzhou and Shenzhen—improved laws and regulations, careful implementation of enforcement action plans, coordination and accountability among IPR enforcement agencies, and a substantially higher level of transparency regarding the government's enforcement activities.

#### **RECOMMENDATIONS:**

### **Promote Effective Criminal Deterrence**

Significantly increase resources for criminal enforcement, particularly in provinces with the

- highest concentrations of IPR violations, such as Guangdong, Fujian, and Zhejiang.
- Establish specialized teams of police, prosecutors and judges who are adequately trained and have sufficient resources to deal with criminal IP cases.
- Commit to amending the Criminal Code to address a number of gaps and weaknesses, particularly with respect to trademark counterfeiting, copyright piracy, and trade secret violations. Consistent with the TRIPS Agreement, the Code should provide for criminalization of all cases of willful counterfeiting and piracy on a "commercial scale." 12 In the short term, amend the December 2004 judicial interpretation on IPR crimes to deal as comprehensively as possible with existing loopholes by reducing thresholds dramatically, and allowing police and prosecutors to pursue cases based on non-numerical factors.
- Ensure that the conditions to criminal enforcement against counterfeiters dealing in counterfeit drugs set out in the Criminal Code do not impose unnecessary obstacles to investigation or enforcement, including requirements that counterfeit drug samples actually pose a risk of harm to human health. All cases involving fake medicines deserve aggressive investigation and enforcement under the Criminal Code.
- Enact new laws or regulations to ensure that criminal and administrative sanctions are available against both the offenders and cinemas that fail to

<sup>12</sup> Unreasonably high thresholds for prosecution under the Criminal Code should be eliminated, including requirements that copyright violations be "for-profit" and proof of certain minimum profit-making by infringers for criminalization of copyright cases involving vendors. Further, new rules should be introduced to ensure that cases may be investigated and prosecuted based on non-numerical thresholds, e.g., for cases involving counterfeit drugs or other products that may cause risks to human health. Future rules should also make clear that criminalization is possible based on an accumulation of circumstantial evidence which indicates a significant level of prior production and sales of offending items.

act against cam-cording of movies in theaters.

- Amend the Criminal Code to make it clear that software piracy by end-users and the creation or use of anti-circumvention measures are subject to criminal sanctions.
- Revise Criminal Code provisions that result in excessive monetary and quantitative thresholds for the prosecution and criminal liability, and eliminate the overly restrictive "for profit" requirement for criminal action against copyright violations. These requirements make it nearly impossible to prosecute even large-scale infringers who reap considerable financial and competitive benefits from piracy.
- Establish a new database to monitor pending and resolved cases, including criminal case transfers, by national and provincial police, as well as the full range of administrative enforcement authorities dealing with counterfeiting and copyright piracy.
- Ensure the full enforcement of Chinese regulations requiring the use of source identifier (SID) codes on optical disks, including speedy provision of data from cases submitted to the PSB's optical disk identification testing laboratory in Shenzhen.

#### **Enhance Administrative and Civil Remedies**

• Strengthen administrative sanctions through the establishment of guidelines for calculating administrative fines and clarify the conditions under which infringing goods and associated production equipment may be destroyed and enhance the transparency of the destruction of seized goods. These objectives could be addressed in the area of trademark counterfeiting by revisiting the decision to suspend the Trademark Office's

- work on new enforcement guidelines for the Trademark Law and Implementing Regulations.
- Amend the relevant administrative remedies provisions to clarify that "harm to the public interest," which is the threshold set forth in the current law, includes any copyright infringement above a de minimis amount. At present, this term is not defined and has been used as an excuse by some enforcement authorities not to take action against even large-scale infringers.
- Encourage a stronger regulatory role by the SAIC and other administrative enforcement authorities over their local offices to ensure consistency in execution and interpretation of established regulations.
- Further develop and expand civil litigation to build upon the recent success of the Beijing Administration of Industry and Commerce (AIC) in the prosecution of landlords responsible for widespread, repeated, and commercial-scale counterfeit activities taking place on their premises.
- Strengthen provisions in the Civil Procedure Code and judicial interpretations of the Supreme People's Court to help facilitate more effective discovery of evidence and the freezing of infringer assets.
- Clarify the relevant legal standards for the award of statutory damages and preliminary injunctions in civil actions. The existing standards are unclear and make it very difficult for right holders to bring civil actions against infringers.
- Raise the current level of maximum statutory damages for piracy of all copyrighted works, including software and DVDs of new movies, from

the current low level of RMB 500,000 (US\$60,000). Also, reduce the unreasonably onerous burdens of proof currently required to show actual damages or lost profits (since, not surprisingly, pirates and counterfeiters almost never retain accurate business records of their illegal dealings).

Engage in open consultation with stakeholders to clarify terminology in the new Internet law to ensure that rights holders are fully protected and damaging loopholes are closed.

#### **Curb Exports**

- Fulfill 2005 JCCT commitments by starting criminal investigations of cases which are detected by Chinese customs. Regulations intended to promote case transfers from customs to the police were issued in early 2006, but apparently have not been effectively implemented to date.
- Raise the maximum fine permitted by the Customs Administration on administrative penalties from its current level, i.e., the lower of 30 percent of the value of goods confiscated, or RMB 50,000 (US\$6,000).

#### **Improve Market Access**

- Increase market and investment access for foreign IP-based products and entities to facilitate the sale of legitimate products and the establishment of legitimate entities.
- Institute credible mechanisms to certify and verify previous JCCT commitments to use legal software by companies and government entities.

For example, require government offices to provide sufficient budgets to legalize all software and create budget metrics and transparent mechanisms to verify software spending, establish independent third-party audits to ensure compliance, and require implementation of a proper software asset management (SAM) program. Further, require companies, as a condition of annual business license renewal, to certify legal use of software and other copyrighted works and implement a SAM program with annual compliance audits.

### Clarify Existing and Enact New IP Legislation

- Ensure that relevant legislation provides meaningful and effective patent, copyright, and trademark protection, consistent with China's obligations under the WTO TRIPS Agreement and other international treaties and norms.
- Ensure that any amendments to China's Patent Law, which are currently under review by SIPO, seek to improve the quality of Chinese patents and the efficiency of China's patent regime while fully protecting the rights of inventors, including ensuring that any limitations or exceptions to patent rights are narrowly tailored and consistent with articles 27, 30, and 31 of the TRIPS Agreement.
- Adopt implementation guidelines to clarify the scope and application process of products covered under data exclusivity regulations. 13
- Revise the definition of "counterfeit medicine" to include "deliberate mislabeling with respect to

<sup>13</sup> New data exclusivity implementing guidelines should explicitly indicate that the State Food and Drug Administration (SFDA) ensures the protection of the data package of innovative drugs as proprietary information and will not accept applications of generic drugs during the six-year exclusivity period, unless the generic producer provides a complete data package demonstrating the safety and efficacy of the drug.

identity or source" in order to ensure the integrity of the medicine supply chain.

- Provide stronger and more reliable copyright and trademark protection in the online environment through accession and implementation of the WIPO Internet Treaties, as committed to in the 2005 ICCT, and take more concrete action against illegal file sharing services and web sites, with immediate attention to loopholes in protection. The new regulations on the protection of copyright on the Internet attempt to do this, but as noted above they are not consistent with international norms.
- Reduce the financial risk that authorities face in enforcing IPR by clarifying legislation to afford reasonable protection from litigation by infringers to AICs and other administrative authorities that have acted in good faith.
- Ensure that the new Regulations on Timely Transfer of Suspected Criminal Cases in the Enforcement of Administrative Law and other related regulations earlier this year which were intended to promote the transfer of administrative cases to the police are actively implemented. Immediately issue new regulations that will clarify that cases should be transferred on-thespot where there is a reasonable basis to believe relevant conditions for criminal prosecution will be satisfied.

## Increase Transparency and Collaboration with Foreign Experts

Continue and expand cooperation among Chinese legal drafters, foreign experts, and industry associations on upcoming changes to IP legislation, including the Patent Law, the Copyright Law, the Trademark Law and the

Anti-Monopoly Law. Continue positive efforts on the part of State Intellectual Property Office (SIPO), Ministry of Commerce (MOFCOM), and AIC in reaching out on these important measures. Begin collaboration as well on corresponding improvements to the PRC Criminal Code.

- Develop more transparent methods of monitoring and publicizing government enforcement efforts to verify enforcement and implementation efforts. This requires maintenance of more detailed statistics (including break downs by region, penalty, etc.) and distribution of these statistics on a much more consistent and frequent basis. The Chamber has commenced cooperation with certain provincial governments in an effort to promote such reforms and establish model programs.
- Form an "Intellectual Property Disputes Panel" or Experts Group within the framework of the JCCT, staffed by Chinese and American IPR experts from both industry and academia, to conduct research into more troublesome legal or practical problems which pose consistent or particularly serious obstacles to effective enforcement. This group could develop joint recommendations on possible structural reforms to the JCCT for further discussion between the governments.

## **Newly-Emerging Industrial Policies**

China's post-WTO accession use of industrial policies to foster the development of strategic sectors is of mounting concern to the Chamber and a broad cross-section of U.S. industry. China is in the process of enacting or amending several different laws and regulations, which, in the eyes of many China

observers, could substantially weaken legal protections for foreign technologies or otherwise erect market access barriers to U.S. companies. These developments are occurring in the areas of antitrust law, patent law reform, subsidies, government procurement, price controls (particularly in the health care sector), backdoor local content requirements, restrictions on foreign investment, unwieldy capitalization requirements, capital controls, and standards policy. A key aim of many such policies is to enable Chinese firms to obtain low- or no-cost access to patented technologies and other innovations owned by foreign rights holders. The Chamber believes that the use of such reforms to advance a single industrial policy goal—namely, to gain advantages for Chinese domestic companies at the expense of overseas economic interests undermines a fundamental tenet of U.S.-China economic relations and calls into question the basis for the long-term cooperation of U.S. business, including the Chamber and its members, with China and Chinese enterprises.

The potential effect of these initiatives has been underscored by the June 28, 2006 "State Council Opinions on Invigorating the Equipment Manufacturing Industry," 14 the publication in February 2006 of the Ministry of Science and Technology's National Medium- and Long-Term Program on Science and Technology Development 2006-2020 (S&T Development Program), and by China's National IPR Strategy, which is currently

being finalized and is expected to be released in late 2006 or early 2007. A common theme underlying these initiatives is the promotion of "self-reliant innovation" by decreasing China's use of foreign technologies. While aspects of these proposals are unobjectionable, others are less benign. For instance, the S&T Development Program includes proposals to use government procurement policy to prefer domestic technologies and influence the development of technology standards, and to more actively challenge perceived "abuses" of IPRs by foreign IPR owners.

Some developments in this area merit particular attention:

### **Anti-Monopoly Law**

After a decade of revision, China's draft Anti-Monopoly Law (AML) is now moving to conclusion. The National People's Congress (NPC) conducted its first reading of the AML in June 2006 and is expected to enact legislation in early 2007. Some commentators have suggested that the AML was intended as a device to encourage the dismantling of provincial and municipal monopolies and to foster the development of a truly national market in China. This would be laudable.

U.S. industry is deeply concerned, however, by public statements from officials and others in China suggesting that a key target of the AML will

<sup>14</sup> These "Opinions" identify 16 categories of strategic priorities for development: digital medical imaging devices and bioengineering devices, large machinery for clean and efficient power generation, major coal-mining machinery, high-speed trains, large waste-treatment equipment, waste-gas treatment equipment, large precision high-speed numerically-controlled machine tools, key equipment for the integrated circuitry industry, and pharmaceutical equipment. Under this plan, the Chinese government would provide financial support for key projects and would encourage large companies to raise capital through securities offerings. The National Development and Reform Commission (NDRC) would be responsible for formulating policies for priority categories and would provide tax incentives to increase research and development in such areas. At the same time, foreign acquisitions of key equipment manufacturing companies would be subject to higher scrutiny by the State Council. Of perhaps most fundamental concern, the Opinions note that the Chinese government intends to reduce preferential treatment for imports, presumably through tariff increases.

be multinational companies in China that have achieved market positions coveted by favored domestic companies. There appears to be widespread misunderstanding of the proper goals of the AML in the minds of the public, as well as those of many Chinese government officials. They often presume that any company with substantial market share or strong IP portfolios has violated or is likely to ultimately violate the AML. Such widespread misunderstandings, promoted in part by irresponsible media reports, foster public resentment against foreign investors and increase the risk of abusive enforcement of the AML in the future—particularly at the local levels.

While the Chamber is pleased that Chinese officials have sought and incorporated advice and comments from a number of foreign competition agencies and other legal experts, concerns remain that certain AML provisions may adversely affect U.S. companies. These provisions include rigid numeric thresholds for establishing dominance and prohibitions on selling or buying products at "unfairly" high or low prices or refusing to trade "without justification." These provisions suggest a formalistic and non-economicsbased approach to competition enforcement contrary to international trends. We are particularly concerned about statements from certain Chinese officials and others that these provisions might be used to target leading innovative U.S. firms.

The current draft of the AML remains vague with respect to IP issues. In particular, the latest draft fails to clarify the meaning of "misuse of IP rights" or whether the exercise of IP rights will incur liability

only if it violates separate provisions of the AML. Industry naturally fears that these and other ambiguities will open the door to abusive exercises of discretion in penalizing foreign investors after the AML is enacted. 15 While the Chamber is pleased that the version of the AML considered during the NPC's first reading reportedly included provisions on administrative monopolies and clarified that IPR owners would not incur liability for protecting their legitimate intellectual property rights, we remain concerned with several aspects of the AML (see above) and particularly wish to ensure that the AML is not applied in a manner that would constitute a disguised restriction on international trade and the lawful exercise of IPRs. The U.S. Chamber and our member companies will continue monitoring developments in the AML process as it unfolds.

#### **RECOMMENDATIONS:**

- Enact an AML and implement regulations that reflect a facts- and economics-based approach to competition enforcement, avoid rigid or formalistic prohibitions, promote consumer welfare, economic efficiency, and respect for IPRs, and are consistent with international standards and practices.
- Ensure consistent and non-discriminatory application of the AML and implement regulations at both national and local levels. We urge the Chinese government to fully take into consideration all of the legal and practical consequences in structuring future enforcement agencies.

<sup>15</sup> In the past few years, the Chinese public has been misled to believe that it has been victimized by patent enforcement and patent licensing activities. The end result is that patent enforcement and licensing are generally labeled as "anticompetitive" or "ÎP misuse." Such distorted views, in combination with ambiguities in the AML with respect to dealing with IPRs, may lead to significant difficulties or barriers for U.S. industry to enforce patent rights in China.

• Clarify the scope of application of the AML to intellectual property rights.

#### Patent Law Reform

In March 2005, China's State Intellectual Property Office (SIPO) published a Researching Guide that proposed numerous amendments to China's patent law. Several of these amendments appear to be designed to improve overall patent quality to strengthen the operation and efficiency of the Chinese patent system and to bring China's patent regime more closely in line with international practice. The U.S. Chamber and its members support these efforts. At the same time, the Chamber is concerned that certain amendments under consideration could deter innovation and trade by weakening the ability of inventors to obtain and enforce patents on novel, useful, and non-obvious innovations.

Of particular concern to the Chamber and its members are amendments that seem designed to rectify what some Chinese refer to as the "unnecessary compromises" that the PRC government is accused of having made during negotiations over the country's entry to the WTO. For example, there are indications that proposed amendments will seek to expand the power of the government to award compulsory licenses for foreign-owned IP.

The Chamber will be monitoring these and other provisions which might restrict or eliminate patent rights in technologies that are implemented in national standards, restrict or eliminate the patentability of software which may or may not produce the so-called "technical results or effects" and other "new" technologies (e.g., biotechnology innovations), add new provisions that would limit or eliminate patent protection in cases of "abuse," and

add new provisions to increase incentives for third parties to request for compulsory licensing of patents.

Chinese officials have stated that these amendments are unlikely to be implemented into law before the end of 2008. A first formal draft of the amendments was issued for comment by foreign experts and associations in early August 2006. This suggests that SIPO is moving forward with drafting legislation at a rapid pace. The comments and research of foreign stakeholders should be given consideration in the development of further drafts.

#### **RECOMMENDATIONS:**

- Develop the third amendment to the Patent Law in an open and transparent manner.
- Ensure that any amendments to China's Patent Law promote innovation and international trade, respect the rights of U.S. patent owners, are consistent with international norms and best practices, and are fully consistent with China's TRIPS obligations—particularly with respect to compulsory licensing.

#### **Subsidies**

Upon its accession to the WTO, China committed to assume the obligations of the WTO Subsidies Agreement. Requirements of the Agreement include the elimination of all export and import substitution subsidies and an annual submission to the WTO on existing subsidies. On April 7, 2006, China issued its first subsidies notification to the WTO, over four years behind schedule. The submission on the surface appears to have been made in good faith, yet there also appear to be some significant omissions.

Now that China is such an important player in the international economy, the lack of transparency in China's subsidies policies is unacceptable. China's failure to have made a timely WTO submission on its entire subsidies programs is understandable considering that China was, until fairly recently, a pure command economy, and subsidies were the rule rather than the exception. Cataloging the extent of subsidization in China is a mammoth task, especially taking into account legacy subsidies that operate through de facto tolerance of non-performing loans—or the continued practice of officiallydirected bank payments—to state owned enterprises.

While we may sympathize with the difficulty China faces in identifying such subsidies, the continued failure of China to produce information in this area is a very serious deficiency and a clear violation of China's commitments to the WTO. We would urge the U.S. government to pay particular attention to this issue in the context of its interaction with China at the WTO and in discussions leading up to the 2007 JCCT.

The Chamber is also closely watching developments in the Chinese steel industry. The rapid expansion of Chinese steel production in recent years has been striking, with much production coming on line even during times of worldwide surplus. While Chinese demand for steel has unquestionably fueled private sector interest in new production, the dramatic expansion of production capacity raises serious questions about the nature of Chinese government support for such expansion.

#### **RECOMMENDATIONS:**

• China should report any subsidies provided through its banking system, such as through policy banks or other state-owned banks; the degree of non-performing loans to China's state sector companies suggests that the bulk of China's subsidization is provided through the banking system.

- China should report any provincial governmentlevel subsidization; next to the banking system, this is where most of the remaining subsidization takes place, and is of particular concern in the case of China's steel industry.
- China should report not only the existence of subsidies, but also include information about the amount of the subsidies.

#### Government Procurement

The Chamber has strongly encouraged the Chinese government to achieve greater transparency and to provide greater market access in the area of government procurement in its ongoing effort to combat corruption. China became an observer to the WTO's Agreement on Government Procurement (GPA) upon its accession in late 2001 and agreed at that time to enter into negotiations to join the agreement "as soon as possible." The 2002 Government Procurement Law marked a step forward in China's efforts to improve transparency, limit corruption, and remove local protectionism. However, it has also restricted foreign companies' access to government procurement. Under the law, government entities, with limited exceptions, are required to procure only domestic goods, services, and public works.

Indeed, in 2004 China proposed software procurement regulations under the national Government Procurement Law that threatened to close off a market with a potential value of \$8 billion to U.S. firms. The U.S. Chamber is pleased that at the 2005 JCCT meeting China committed to suspend the implementation of those draft rules. However, to bring China's government procurement regime into conformity with principles of the GPA, China needs to revise or retract the discriminatory provisions of the Government Procurement Law.

Despite some progress in opening its government procurement regime, it seems that China is moving away from the spirit and letter of its WTO accession commitments. More than four years after its WTO accession, China has yet to fulfill its pledge to initiate negotiations for membership in the GPA and has, in fact, proposed procurement regulations and implementation rules that would severely restrict access by non-Chinese companies to China's government procurement market.

China agreed to hold technical discussions on GPA accession at the 2005 JCCT meeting. Yet, these discussions only began in February 2006. At the April 2006 JCCT, China committed to commence formal negotiations to join the GPA no later than December 2007, six years after acceding to the WTO.

Of additional note is the Ministry of Finance's (MOF) mid-June 2006 release of its "Opinions on Implementing Government Procurement Policies that Encourage Indigenous Innovation," that set forth the utility of Government Procurement as a means to manipulate incentives to develop strategic technologies, but fail completely to reference the Chinese government's commitment to GPA membership. The Chamber believes it is essential that China join the GPA as soon as possible, and on strong commercial terms that ensure non-

discriminatory, transparent, merit-based, and technology-neutral procurement.

The Chamber is further concerned about the potential precedent-setting implications for government procurement given at an early January 2006 triministerial announcement. The announcement directed all government agencies to follow a "preference for" wireless authentication and privacy infrastructure (WAPI) for any Wireless Local Area Networks (WLAN) products procured for government use (the WAPI Notice).

Furthermore, concern over the intended scope of the WAPI Notice was raised in early February when China made three "urgent" notifications to the WTO under Technical Barriers to Trade (TBT) Articles 2.10.1 and 5.7.1 regarding the WAPI Notice. These TBT Articles are designed to enable governments to enact a regulation without the normal comment period, in cases of "urgent health, safety or national security." China's intentions behind the notice and its filing of urgent notifications in Geneva are uncertain. The U.S. Chamber and its members have serious concerns as to the potential implications of these efforts for government procurement and hope these issues can be resolved quickly.

The Chamber feels strongly that China's implementation of its procurement law and any relevant sector-specific regulations in this area, should not exclude or diminish the ability of foreign companies to fully participate in China's procurement market. An open, competitive, transparent, non-discriminatory, and technologyneutral government procurement regime is in China's interest and in the interest of China's trading partners. An open government procurement market encourages investment and active participation by leading foreign companies in China's economy and

brings superior products and services for the best value to China's government and consumers.

#### **RECOMMENDATIONS:**

- Move more quickly to enter negotiations to join GPA, even while technical discussions with GPA members continue, with a target date for completing the negotiations no later than December 31, 2007.
- Prior to joining the GPA, conduct government procurement consistent with GPA obligations by committing to national treatment of all firms as part of its WTO commitments.

#### **Technology Neutral Government Procurement**

- Reaffirm a commitment to non-discriminatory, merit-based, technology neutral, and transparent government procurement.
- Adhere to the 2005 JCCT commitment to indefinitely suspend the drafting of implementation rules on government software procurement that would limit the central and local governments' ability to purchase foreign software.
- Ensure that sufficient funds are available to government entities at all levels to procure software and verify full implementation of legal software use within these entities; establish a means to verify compliance. 16

#### **Standards**

The U.S. Chamber is concerned with China's recent efforts to use standards policies to erect barriers to free competition, in a manner that is inconsistent with China's WTO obligations. The Chamber is encouraged that China has recently become more deeply engaged in international standards-setting bodies and introduced various standardization system reforms. Yet, this progress may be eroded by China's efforts to develop and mandate unique national technical standards that diverge from existing international standards, as well as indications that China may subject essential patents in these mandatory standards to compulsory licensing or otherwise impede the ability of owners of essential patents to license them on marketbased terms.

The Chamber's principal concerns regarding the direction in which China's standards policies are evolving are as follows:

• China is adopting national standards that diverge from existing, widely adopted international standards. As the examples below demonstrate, Chinese standard-setting entities often at the direction of Chinese government officials—have on several occasions adopted or indicated intent to adopt national technology standards that diverge from existing, widely adopted international standards. Often, Chinese authorities are facilitating and allegedly

<sup>16</sup> As outlined in the aforementioned text, credible mechanisms to certify and verify use of legal software by companies and government entities include the following: sufficient government budgets to legalize all software, budget metrics and transparent mechanisms to verify software spending, independent third-party audits to ensure compliance, and a proper software asset management (SAM) program. Furthermore, companies should be required to certify legal use of software and other copyrighted works and implement a SAM program with annual compliance audits as a condition of annual business license renewal, listing on China's financial exchanges, and participating in government tendering.

subsidizing the research and technical work needed to create these domestic standards in an apparent effort to reduce China's use of foreign-origin technologies and to avoid royalty payments to foreign innovators. These divergent Chinese standards raise barriers to trade by excluding from the Chinese marketplace non-Chinese products that implement widely adopted international standards. China's adoption of such divergent national standards potentially violates China's commitments under the WTO Agreement on the TBT Agreement, which provides where "relevant international standards exist . . . Members shall use them." (Art. 2.4). To the extent that China's adoption of divergent technical standards does in fact create barriers to foreign competition, this potentially would also violate China's obligation to ensure that its technical regulations do not have "the effect of creating unnecessary obstacles to international trade" and are not "more trade-restrictive than necessary to fulfill a legitimate objective." (TBT Agreement, Art. 2.2). The July 11, 2006 approval of the EPCglobal UHF Generation 2 Air Interface Protocol standard by the International Standards Organization (ISO) provides a truly global consensus on the issue. More than 60 of the world's premier technology corporations worked to develop the standard, and the Chinese government has a clear responsibility to adopt its national standards in line with this consensus.

China is mandating technology standards in cases where voluntary, market-led standards would be more appropriate and would pose fewer barriers to trade. Competition and innovation are best served where technology standards are developed in an open, voluntary, and market-driven process, and where implementers are free to choose among competing standards in the marketplace.

Mandatory standards should be avoided wherever possible because such standards restrict consumer choice, thwart competition, and chill innovation. Where mandatory standards are framed so as to exclude products with equal or superior performance characteristics, such standards are particularly likely to pose obstacles to trade and raise WTO concerns. See, e.g., TBT Agreement, Art. 2.2; 2.8 ("Wherever appropriate, Members shall specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics.").

• China is adopting policies that would require holders of essential patents to license their technologies at below-market rates. As described below, China has undertaken efforts on several fronts to force owners of patented technologies that are essential to the implementation of Chinese national standards to license these technologies under low-cost or royalty-free terms. In certain cases, this could result in a form of compelled technology transfer, one that in practice might violate Articles 30 and 31 of the WTO TRIPS Agreement. At a minimum, when the owner of an essential patent agrees to license its technologies to standards implementers under reasonable and non-discriminatory terms, the Chinese government should allow the marketplace to lead, and should not compel royalty rate caps or set other licensing terms.

Concerns that China might seek to use standards policies as a means to develop and protect domestic industries from foreign competition is based on recent political statements, specific funding support to local standards working groups, certain existing standardization efforts, and unfulfilled JCCT commitments. For example, the 11th Five-Year Plan propagates the concept of

"self-reliant innovation," which captures a national political desire to accelerate the development of domestic research and development, and to reduce reliance on foreign technologies. This concept is subject to a variety of interpretations, and could be implemented in a manner that would discriminate against "foreign innovation."

Furthermore, several Chinese ministries are researching the role that technical standards should have in the development of the Chinese technology industry. For instance, the Standardization Administration of China (SAC) is currently working on a "Study on Development Strategies of Chinese Technical Standards," which expresses a desire by SAC to develop local standards solely as a means to protect domestic companies. This study is also expected to provide direction to the Interim Regulation for National Standards Involving Patents, the current status of which is unclear. The draft regulation also can be interpreted as supporting the use of compulsory licensing of essential patents for China's national standards, which is inconsistent with practices in the United States and European Union.

The Chamber and its members are particularly apprehensive over signals of a trend to develop mandatory standards that undermine IPR in the name of public interest. Indeed, this very issue is being debated by the SIPO in its current drafting of the third set of amendments to China's patent law. These developments hint at the potential use of mandatory national standards in private and government procurement as a tool for industrial development.

Other recent events illustrate more tangible and immediate efforts by China to use standards policy and practices to limit foreign competition and to advance industrial policy goals. The Chinese government is currently engaged in several efforts to develop and adopt divergent national standards, despite the existence of wellestablished international standards. China has already adopted a divergent standard for enhanced versatile discs (EVD) for recording media and is attempting to adopt national standards in automotives, distilled spirits, and information technology (IT). Examples of divergent IT standards include audio and video coding standard (AVS) for media/television, internet grouping and resource sharing (IGRS) for internet connectivity, time division synchronous code-division multiple access (TD-SCDMA) for wireless telecom, and WLAN encryption standard for wireless communications devices.

The Chinese government is also considering mandating a unique national standard for radio frequency identification (RFID). Of equal concern is China's failure to allocate a frequency designation for ultra high frequency (UHF) RFID tags. 17 The RFID tag stores a product's Electronic Product Code (EPC), a unique number that is used to identify a specific item in the supply chain. The use of EPC can considerably improve global supply chain efficiencies. However, if China mandates its own national standard for RFID and fails to allocate a frequency designation for (UHF) RFID, U.S. companies will be disadvantaged in their manufacturing operations in China and around the world.

<sup>17</sup> Without a frequency allocation, goods manufactured in China will have to be tagged outside of the country, adding costs to the producer.

These recent developments, in combination with a lack of compliance with existing JCCT commitments, reinforce the Chamber's concern that China intends to use national standards to protect local industry and to force technology transfer. The Chamber strongly encourages China's development of open, voluntary, marketled standards that respect IPR, including the right of patent holders to derive reasonable compensation from IP. Competition, innovation, and global trade are best served by standards developed by market forces. Keeping foreign goods and services out of China will only hold back China's economic development and deny its government, people, and businesses some of the best tools available to fuel growth and productivity. Foreign companies can help China achieve many of its development goals if they are permitted to compete in the marketplace where their IP is protected.

The Chamber was encouraged when the Chinese government, at the 2006 JCCT meeting, reaffirmed its 2004 JCCT commitment to adhere to technology neutrality with respect to Third-Generation (3G) standards, and that China agreed to ensure that telecommunications service providers will be allowed to make their own choices as to which standard to adopt. The Chamber also welcomed China's commitment to issue licenses for all 3G standards in a technologically-neutral manner that does not promote or favor one standard over another. The Chamber will be monitoring this issue closely as an indication of China's willingness to promote a pro-trade and pro-innovation approach to standards policy.

#### **RECOMMENDATIONS:**

#### **Standards Development**

- Align China's technical regulations and national standards development efforts with internationallyrecognized standards and practices, including adherence to the transparency notice and comment provision of the WTO TBT Agreement (e.g., Article 2.0 and Annex 3. Sections J, L, M, & N).
- Participate in the global standards setting process for the EPC through EPC Global China, which is part of the Article Numbering Center of China (ANCC) under SAC.

### **Intellectual Property**

- Adopt and publicize IPR policies and principles for standards-setting organizations that balance the interests of stakeholders, encourage innovation, and are consistent with international practice for treatment of intellectual property, such as the IPR policies of leading international standards bodies.
- Refrain from taking measures that have the effect of compulsory patent licensing or that would impose other limitations on patent rights, even in cases of mandatory national standards.
- Respect IPRs of patent holders, including the right to derive reasonable, market-based compensation (e.g., royalties) from essential IP in standards. Refrain from interfering with the process of determining royalties by patent holders.
- Provide foreign companies with the same access to China's standard setting process that domestic companies enjoy.

### **Technology Neutrality**

- Adhere to China's 2006 JCCT commitment to support adoption of 3G telecommunications standards and issue licenses for all 3G standards in a technologically-neutral and non-discriminatory manner. Ensure that telecommunication service providers are allowed to independently adopt standards and prohibit Chinese authorities from directly or indirectly interfering in the negotiation of technology transfer and royalty agreements between foreign technology companies and its Chinese counterparts.
- We specifically urge the U.S. government to review China's compliance with its JCCT commitments in these areas and engage on these matters when opportunities arise, and to insist on full and good-faith implementation of these commitments.
- Ensure that standards do not favor or discriminate against any specific vendor, technology, or development model. Technology neutrality is best served where standards are developed in a voluntary, market-led process and where firms are free to choose among competing standards that are available on reasonable and non-discriminatory terms.
- Honor the commitment under the TBT Agreement to utilize existing international standards where such standards exist and ensure that Chinese standards policies and practices do not have "the effect of creating unnecessary obstacles to international trade" and are not "more trade restrictive than necessary." Minimize the use of mandatory standards.
- Allocate a frequency spectrum of at least 5MHz within the 860-960 MHz band for use of RFID

with approved power levels of 4W.

### **Transparency**

- Consistently circulate all relevant draft laws, rules, and regulations for comment to the U.S. government and foreign industries, including the most recent revisions of the SAC draft Provision for Patent Issues Relating to National Standards, draft Amendments to the Patent Law, and draft versions of the Anti-Monopoly Law.
- Allow foreign companies to provide input in the standard-setting process on equal terms with Chinese companies, including in China's many standards setting organizations. The opportunity to participate in standard-setting bodies, which is supported directly or indirectly by the Chinese government, should not be dependent upon a party sharing patented technologies on a royaltyfree basis.

# Distribution, Direct Selling, and **Franchising Services**

#### **Distribution Services**

China's full and consistent implementation of its distribution services obligations is of critical interest to our members. In the last year, the Chinese government has implemented improvements in the distribution license application and approval process, including resolution of outstanding tax and customs issues. The Chamber also appreciates Ministry of Commerce (MOFCOM) efforts to instruct local commercial bureaus to begin processing the backlog of applications.

Notwithstanding some improvements, the Chamber remains concerned over continued product and

service restrictions and inconsistent national treatment in the approval process. We seek assurance that MOFCOM and relevant local authorities will exercise their approval authority in an expeditious and non-discriminatory manner. Of particular concern is the provision in the April 2004 regulations that permits local approval authorities to withhold wholesale and retail distribution licenses to foreign firms when urban commercial network plans have not yet been formulated. As a majority of cities have not yet formulated urban commercial network plans, this provision could potentially serve as a de facto restriction on the operation of foreign companies.

The Chamber is further concerned with two articles in the Measures for the Administration on Foreign Investment in the Commercial Sector (Measures for Foreign Investment) issued by the MOFCOM. The first, Article 18, stipulates that if a foreign retailer opens more than 30 stores in China and sells certain commodities, the capital contribution of the foreign investor to the joint venture may not exceed 49 percent. Restricted commodities include books, magazines, pharmaceuticals, chemical fertilizers, processed oils, sugar, cotton, tobacco, CDs, and DVDs, among others. 18 These restrictions do not apply to domestic retailers and place tremendous pressure on U.S. businesses. Therefore, the Chamber urges the elimination of this discriminatory measure, which puts U.S. firms at a competitive disadvantage.

Another concern involves the implementation of the requisite level of registered capital as stipulated in the measure. Article 7 requires that the minimum registered capital for foreign retail

investors must comply with the relevant provisions in the Company Law and other regulations. The Company Law and relevant regulations state that the minimum registered capital for a wholesaler is 500,000 RMB (approximately \$60,000) and the minimum registered capital for retailers is 300,000 RMB (approximately \$36,000). However, in practice, U.S. retailers are usually asked by MOFCOM to increase their registered capital in an amount ranging from \$1 million to \$2.1 million each time they apply for a new outlet. In contrast, no such provision exists for domestic retailers regardless of the number of outlets established.

The Chamber believes that the registered capital provisions should be equitably administered to U.S. and Chinese firms.

Currently, due to infrastructure limitations and restrictive local requirements, no domestic or foreign distribution company holds a market share greater than two percent, or maintains a nationwide network. The easing of provincial and local restrictions on national distribution networks will foster economic growth and employment throughout China, especially in underserved rural areas.

#### **Direct Sales**

China's WTO market access commitments include its commitment to permit sales away from a fixed location, also known as direct selling, by the end of 2004. In September 2005, nine months after the WTO deadline, China issued final versions of its implementation measures, the Measures for the Administration of Direct Selling and the Regulations on the Administration of Anti-Pyramid Sales Scams.

<sup>18</sup> Further discussion of how the Measures for Foreign Investment affects specific industries, such as energy and publications, are contained in this paper's section on "Sectoral Issues."

These implementing regulations fall short of international standards and are not in keeping with China's commitments made during the run-up to WTO accession.

Under the new regulations, companies are prohibited from paying distributors more than 30 percent of their individual retail sales as commission. Thus, volume bonuses and fees for other services are prohibited. This treatment of sales personnel is inconsistent with Chinese policy for every other sector involving commercial sales. As a consequence of the new regulations, many direct selling companies fear that their hard-earned market positions will be eroded and that sales levels will fall.

In addition to the restriction on compensation, the new Anti-Chuan Xiao (chain selling) regulation has essentially banned traditional multi-level marketing (MLM) sales plans despite the fact that they are legal and permitted in nearly 170 countries. The currently banned multi-level compensation system is integral to the distributor compensation structures of more than 90 percent of direct sales companies worldwide. Traditional MLM compensation rewards the building and management of a successful sales force by paying compensation based on team sales, where upstream personnel are compensated based on downstream sales. The new chain selling regulation defines MLM sales plans as an element of fraud. While consumer protection measures are necessary and welcomed by direct selling companies, those measures need not prohibit bonus payments for training and sales support and other incentives that are based on legitimate metrics such as group sales volume.

An additional concern is a lack of transparency in the current system for licensing direct selling companies. While direct selling companies understand the need for caution as China considers license

applications, they also deserve timely communication from officials considering their applications, further clarification of the actual licensing requirements, and decisions under the process made within the time frame outlined in the regulations.

### **Franchising Services**

The Chamber is concerned that franchise regulations issued by MOFCOM, the Measures for the Administration of Commercial Franchises, which took effect in February 2005, place unnecessary limits on the traditional franchising model. Of particular concern is a provision that requires franchisers to own and operate at least two units in China for one year before offering franchises in China. MOFCOM and the State Council Legislative Affairs Office are currently working on a draft update to these regulations. The Chamber believes Chinese authorities should address certain areas of ambiguity in the regulations and work to find a solution that makes the regulations less burdensome to foreign franchise operators. This is of particular importance to those entities that do not establish a presence, but rather license their business model.

The U.S. Chamber and its members welcome working with MOFCOM and the State Council, as well as with the U.S. Department of Commerce and USTR, to build a reasonable framework for the protection of investors and the development of franchised businesses in China.

### **RECOMMENDATIONS:**

#### **Distribution Services**

• Ensure that newly-issued distribution services regulations requiring wholesaling and retailing enterprises to comply with municipal commercial development rules are applied on a national treatment basis.

- Consider elimination of Article 18 of the Measures of Foreign Investment.
- Revisit the manner in which the article for minimum registered capital for retailers is implemented.
- Facilitate the licensing process for large, foreignowned retail stores that have interest in opening branches in multiple provinces, each of which has separate licensing requirements.

### Compensation

- Remove the 30 percent arbitrary cap on personal retail sales commission and permit direct selling companies to compensate their independent contractors for sales-support services and distributors with bonus payments based on legitimate metrics such as ancillary services and the volume and value of products sold.
- Allow direct selling companies to conduct operations by paying for both sales and marketing services by independent contractors, as well as by company employees.

#### Multi-level Marketing (MLM)

Remove language in the regulations banning
 Chuan Xiao (chain selling) that is prejudicial
 to a form of direct selling known as MLM.
 The language that equates MLM to fraud is
 detrimental to the global reputation of companies
 that employ MLM as a means of compensation
 and could be removed without changing the
 prohibitions that exist within the ban.

Revisit the ban on MLM compensation. MLM
is a legitimate business practice that should be
considered a legal means of compensation in
China at some point in the future.

#### **Franchising Services**

- Seek industry input on alternatives to the "two plus one provision" that requires franchisers to own and operate at least two units in China for one year before offering franchises in China.
- State clearly whether franchising regulations apply to foreign-incorporated franchisors. If the regulations are intended to apply to foreignincorporated franchisors, language should be included to state that nothing in the regulations is intended to prohibit or impede cross-border franchising by foreign-incorporated franchisors.
- Continue to seek industry input on the draft regulations and disseminate the latest version more broadly and in a timely manner.
- Clarify vague information disclosure requirements and a company's liability if these requirements are not met.

# **Conformity Assessment**

The Chamber is concerned that conformity assessment practices continue to serve as a non-tariff barrier to trade to the Chinese marketplace. China committed to provide accreditation eligibility to foreign-owned joint venture conformity assessment bodies two years after China's accession to the WTO. However, more than four years after China's accession, accreditation has not been granted to any foreign-invested conformity

assessment bodies. As a result, exporters are often required to submit products to a Chinese lab for tests that have already been performed abroad. Furthermore, redundant testing requirements among Chinese agencies result in added costs and delays for imported products. The Chamber encourages the U.S. government to work with the Chinese government to eliminate duplication in certification requirements, especially in the areas of radio and telecommunications equipment, medical equipment, and automobiles.

#### **RECOMMENDATIONS:**

#### **Conformity Assessment**

- Grant accreditation to foreign-invested conformity assessment bodies.
- Allow for mutual recognition of tests and inspections by the State Food and Drug Administration (SFDA) and the Administration of Quality Supervision, Inspection and Quarantine (AQSIQ).
- Eliminate regulatory redundancy in type testing, factory inspections, and customs inspections that increase costs and delays, but fail to improve legitimate health and safety standards.

#### **Investment Restrictions**

China has for many years maintained a high degree of control over investment by foreign entities in its marketplace through its annually published "Investment Catalogue" detailing encouraged and prohibited industries. As detailed below, Chamber members in a range of sectors in China are finding

that their efforts to expand or gain access to the Chinese marketplace are being checked by new restrictions on their investment decisions. A number of Chamber members have seen transactions interrupted by new government scrutiny. In recent months, the Chinese government has issued a variety of proclamations that will increase the burdens on Chamber members, including the recently issued "Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors," provisions of the Anti-Monopoly Law that require companies with approximately \$100 million in sales in China to notify Chinese authorities of proposed mergers. Also problematic are the references in the June 2006 "State Council Opinions on Invigorating the Equipment Manufacturing Industry" to restrictions on foreign acquisition of certain manufacturing companies, as well as the range of industrial planning documents that discourage foreign participation in China's emerging industries. These provisions are in addition to the longstanding barriers to entry created through unreasonably high capitalization requirements (notably in the financial services industry), restrictions on the legal form through which companies can operate in China, and unwieldy geographic operating restrictions.

#### **RECOMMENDATIONS:**

• China should refrain from arbitrary restrictions on market activity by foreign private sector companies, particularly in investment decision making. Such investment has been a key determinant of Chinese economic health, and curtailing such efforts is not in China's long-term economic best interest.

#### Customs

Inefficient and inconsistent customs clearance procedures are major obstacles for importers and exporters in China. Customs procedures and charges vary from port to port. Customs clearance is not available 24 hours-a-day at all ports of entry and even when customs officers are available, not all clearance activities can be carried out. Customs Electronic Data Interchange (EDI) systems are unstable and cause massive delays when they fail, and the fees paid to the e-ports and private firms that run these systems are excessive and rising rapidly. These concerns raise specific WTO questions, particularly under Articles V, VII and X obligations of the General Agreement on Tariffs and Trade (GATT).

#### **RECOMMENDATIONS:**

- China should streamline and harmonize customs procedures throughout the country and eliminate local 'add-on' fees that attempt to get around these uniform fees.
- Customs should work with industry to create an EDI system that is low-cost, stable, and a service center for industry, not a profit center.
- Bonding procedures should be greatly simplified to facilitate processing trade and transshipment.
- China should allow pre-clearance of goods when proper information is provided in advance.

# **Sectoral Issues**

China's WTO implementation record in 2005 was decidedly mixed. U.S. companies continue to face market access barriers in agriculture, audiovisual

products, automobiles, aviation, energy, express delivery services, financial services, medical technology, pharmaceuticals, publications, sound recordings, and telecommunications services. For example, China has failed to address outstanding concerns over branching rights for foreign insurance companies that would provide the market access China promised when it joined the WTO. Further, even as the Chamber recognizes that China has taken some steps to establish independent regulators in the telecommunications and express delivery services sectors, concern remains over current and pending policies that appear to be structured to inhibit WTO market access commitments.

As China nears the end of its phase-in period for WTO implementation, it should also expand market access in a manner that is consistent with the letter and spirit of its WTO commitments. In particular, the U.S. Chamber hopes that China will act at next year's ICCT to significantly expand market access for U.S. suppliers of software, audiovisual and entertainment products and services, and financial services. The U.S. business community and others that vigorously advocated China's WTO membership offered their support expecting that China would continue on a path toward greater openness; the Chamber views China's WTO accession as a floor, not a ceiling, for continued progress. As we near the end of China's accession process, progress in market access for U.S. companies appears to be stalled. Decisions by China to expand market access would benefit the growing bilateral trade deficit and create parity and stability in the bilateral commercial relationship.

# Agriculture

Agricultural trade is a bright spot in the U.S.-China

trade relationship. China has made progress in addressing a range of concerns, such as allocating trading and distribution rights to foreign enterprises in the agriculture and food sector. China has further achieved progress through implementing tariff reductions on agricultural goods in a timely fashion. Agricultural trade, however, will not reach its full potential for U.S. producers unless China significantly reduces the application of non-tariff barriers to agricultural imports.

Issues of concern to the Chamber include the continuing application of non-transparent sanitary and phytosanitary measures, such as Decree 73, issued by the General Administration for Quality Supervision and Import Quarantine (AQSIQ), which lack scientific justification and add risk premiums to the imported market price of agricultural products. The Chamber raised this same concern as part of the preparation for last year's JCCT, and yet no progress has been made in the past year to rectify the situation.

Decree 73 was not properly notified to the WTO and contains troubling regulations that provide AQSIQ with blanket authority to void import permits in the case of a government-issued warning or ban. Specifically, Decree 73 requires that all contracts for the importation of soybeans, as well as other products subject to the quarantine entry process, include Chinese quarantine requirements as a contract term. U.S. industry is concerned that this requirement will result in a shift to the exporter of all the economic risk associated with complying with Chinese quarantine and food safety requirements; this practice is inconsistent with international trading practices. Decree 73 could further result in government-sanctioned defaults on contracts for imported agricultural products similar to those that occurred in 2004 when a host of

Chinese importers defaulted on soybean contracts on a massive scale.

In addition to the Chamber's apprehension over Decree 73, there is concern with the policy of automatic licensing, which has been used as a tool to discriminate against foreign players through issuance of the import licenses solely to domestic companies. This practice frustrates the ability of foreign-owned companies to exercise the trading rights granted through China's WTO accession.

At the April 2006 JCCT meeting, China conditionally committed to removing restrictions on imports of U.S. beef, subject to technical talks between the two governments. This is good news for U.S. ranchers, given the potential market represented by China. However, continued concerns exist over the length of time necessary for further technical discussions on bovine spongiform encephalopathy (BSE), or mad cow disease, as well as the potential that as-yet unrevealed sanitary and phytosanitary measures will further stall progress to opening China's market to U.S. beef.

Furthermore, the agricultural-chemical industry continues to suffer from significant intellectual property theft. According to CropLife International's rough estimates, as much as 30 percent of ag-chem products sold in certain areas of China are counterfeit, and some of these chemicals are destined for export. IPR infringement in this sector not only harms legitimate manufacturers, but the use of counterfeit chemicals often entails financial losses for individual farmers, and can cause significant environmental and health damages—particularly with regard to food crops. The development of China's nascent ag-chem industry and associated regulatory regime is being dealt a serious blow by the proliferation of IP theft in this sector.

Finally, the U.S. Chamber will be watching the market for corn imports in China with increased interest in 2007. While stored surpluses and new harvests of corn in China have in recent years been adequate to meet much of China's demand for corn, the recent increased demand suggests that this could be an important market for U.S. exports. Past experience with new markets for imported commodities in China suggest that attention to the development of this new market will be required of agricultural and quarantine officials in China and the United States.

#### **RECOMMENDATIONS:**

- Respond to concerns over Decree 73 by eliminating any provisions that are not scientifically based.
- Review the automatic import licensing procedures for agricultural products to ensure fair and equal treatment of domestic and foreign enterprises.
- Support and encourage public-private sector efforts to improve protection and enforcement of IPR among the Chinese farming community.
- Move expeditiously to remove restrictions on imports of U.S. beef, following on commitments at the April 2006 JCCT.

#### **Audiovisual Products**

Chinese consumers and enterprises must have the opportunity to consume and purchase legitimate foreign IP-based products that they are currently illegally purchasing and using in pirated form. Elimination of widespread copyright piracy would translate into billions of dollars of sales and exports by U.S. companies.

The Chamber hopes that China will act immediately to remedy the distorted playing field on which U.S. film producers and distributors currently operate in China. In addition to the lax enforcement of IPR, market access barriers inhibit providers from building a legitimate audiovisual (AV) market; foreign-owned companies are not allowed to hold a majority share of distribution companies, and are completely forbidden from publishing AV products. Moreover, foreigncontrolled retailers are prohibited from obtaining retail AV licenses, which prevents U.S. companies from marketing legitimate DVD products in major foreign-controlled hypermarkets. In contrast to the difficulties in selling legitimate AV products, there is little government intervention to prevent the plethora of illegal DVD stores openly selling pirated goods. Retailers, distributors, and in some cases, manufacturers who are caught involved in copyright piracy are not frequently prosecuted because of the artificially high criminal thresholds.

Furthermore, the illegal DVD market is supported by film import quotas, a distribution duopoly, and release delays for distribution of approved film in cinemas, all of which create a vacuum filled by copyright violators. This negatively impacts the entire value chain of the industry in China, from importation to distribution and to exhibition. China could address these problems by taking the following steps: (1) China should relax its selfimposed cap on the number of foreign films that are allowed to be imported or distributed on a revenue-sharing basis above the floor that was established by China's December 2001 WTO commitments; 19 (2) streamline the clearance and censorship process, including adoption of a film

rating system; and (3) allow more timely release of foreign films in cinemas to negate the impact of piracy. In recent years, China has placed, without reasonable notice, a moratoria on the exhibition of foreign films in an attempt to bolster viewership of newly-released domestic films. This practice distorts the marketplace and spikes the demand for pirated versions of foreign films that are withdrawn or withheld from Chinese consumers, which seems to contravene screen quota provisions of the GATT.

In the area of broadcasting, the limitations on the amount of foreign programming allowed—and the outlets available for foreign programming including an effective prohibition during prime viewing hours—further restrict opportunities for U.S. content providers.

#### **RECOMMENDATIONS:**

- Revoke the licenses of manufacturers, distributors, and retail outlets repeatedly found dealing in pirated products.
- Lower or completely eradicate the criminal thresholds for the prosecution of copyright infringing activities.
- End the discriminatory treatment of foreign retailers by allowing them to obtain retail AV licenses.
- Allow foreign-owned enterprises to invest in and hold a majority share for the distribution and publication of AV products.

- Increase the number of foreign films approved for distribution beyond the current low-level on a non-bound basis.
- Cease the imposition of arbitrary blackout periods on foreign films.
- Streamline the licensing procedures for large retailers.
- Enact an enforceable ban on the sale of audiovisual media by street vendors.
- Streamline clearance of films and videos and establish a film ratings system.

#### **Automotive Sector**

Since the 2004 publication of the Auto Industry Development Policy (AIDP), the PRC government has issued numerous new policies and regulations affecting the automotive sector. Many of these new auto policies relate directly to commitments China made as part of its accession to the WTO.

China has implemented many of its key WTO commitments in the automotive sector. China has lowered tariffs, begun the process of allowing whollyowned vehicle distribution outlets, and reduced restrictions on the establishment of auto financing entities. Nevertheless, it appears that some Chinese officials maintain a vision of a national Chinese auto industry that is separate and distinct from the global industry and inherently discriminatory. This has manifested itself in ways that raise questions

<sup>19</sup> China permits some distribution of foreign films on a licensing basis, but given China's state monopoly on film distribution, the terms of such licenses are not as a general rule negotiated on commercially reasonable terms. As a result, the only commercially-viable channel through which to operate a business showing first-run foreign films in China is on a revenue-sharing basis with the state distribution monopolies.

regarding the consistency of certain policies and regulations with China's WTO commitments.

The Measures on the Management of Parts Import Constituting an Entire Automobile, effective April 1, 2005, would require auto manufacturers to pay complete built-up vehicle tariffs on imported parts used to assemble vehicles in China if the assembled vehicles include a certain level of imported parts. Should they remain in place, these measures are likely to interfere with the normal market forces that govern automotive trade and investment patterns between China and the rest of the world. The U.S. government and European Union are in the process of pursuing discussions with China on the compliance of these measures with China's commitment to eliminate local content requirements under its WTO obligations. In July 2006, China suspended some aspects of the measures until 2008. The U.S. Chamber hopes that this decision signals the longer term intention of the Chinese government to do away with the measures entirely.

IPR violations (e.g., counterfeit auto parts, patent and trademark infringement) in China's auto sector represent a serious and growing problem that presents significant road safety challenges to millions of consumers and their government, which threatens the long-term stable development of the Chinese auto sector. Despite stronger national IPR laws and fines in China, counterfeit auto parts, patent infringement, and trademark violations are still common, especially at the local level.

In recent years, a range of government agencies in China have issued many new technical measures aimed at regulating the automotive sector. A number of agencies have made important efforts to improve transparency in rulemaking, including the process of notifying stakeholders of new

automotive regulations. However, China continues to implement new and unique automotive standards for the Chinese marketplace, despite the availability of market-tested international standards. Chinese standard-setting bodies do occasionally reference international standards, but then frequently cobble together final standards that are confusing and are often announced with minimal notice to stakeholders. This not only fails to serve China's important health and safety mandates, but also adds unnecessary burdens, complicates global auto standards harmonization efforts, and hinders China's integration into the global automotive industry.

#### **RECOMMENDATIONS:**

- China agreed to eliminate all trade-related investment measures (TRIMs) upon accession to the WTO; China's Measures on the Management of Parts Import Constituting an Entire Automobile should be revoked or revised to be consistent with China's WTO TRIMs commitments.
- China should implement an IPR protection framework that effectively addresses the size and scope of its automotive IPR violation issues. Stronger laws, rules and administrative guidance are needed. Most importantly, enforcement must be implemented effectively in order to deter recalcitrant counterfeiters.
- When considering implementing a new automotive regulation, China should consider the interests of all stakeholders and undertake all reasonable efforts to be transparent in adopting such a regulation. With respect to standard-setting, China should, whenever possible, wholly adopt pre-existing international auto standards and

regulations and avoid mixing different international auto standard models.

#### Aviation

China did not make WTO commitments to open up its aviation services sector, although significant steps were taken in 2004 to open its market to U.S. carriers. The U.S. Chamber appreciates China's efforts to increase market access in this sector and its promises to take further market liberalization steps, such as eliminating government price regulations by 2008. The Chamber also encourages China to move rapidly toward full liberalization of its aviation relationship with the United States and other major trading partners. The market, not the government, should determine where and when carriers fly. The technical management techniques of China's aviation market—airport and en-route fees, airtraffic control, airport management, etc.—are generally both costly and inefficient. China should work with international carriers to allow greater participation in the fee development process, improvement of Air Traffic Control (ATC) procedures, and employee hiring.

U.S. carriers should have the opportunity to participate in the airport and aviation fee development process in China. Airports compete for air service by several means including geographical locations and fee structures. Transparency in fee development allows airlines and other stakeholders to participate and assess the economic justification used to determine an airport's fee structure. Additionally, allowing all airline operators to participate in the development process helps airlines understand the terms used for imposing fees and ensures fees are fairly and equitably assessed on all users without preference to the flag carriers.

Further, foreign carriers face restrictions on directly hiring personnel, which are inconsistent with the spirit of China's WTO accession commitments. Presently, all foreign airlines in China must apply to the Foreign Airlines Service Corporation (FASCO) for the assignment of Chinese personnel to work in foreign carriers' local offices. Personnel are assigned to airlines by FASCO on individual fixed term contracts, usually for a two-year duration with an option to extend. Employee wages are paid by the foreign carrier to FASCO, which passes on an unspecified portion to the employee. U.S. carriers invest significant time and money in training these employees to meet their service standards. Under the current system, carriers are faced with the dilemma of paying fees in excess of market rates to renew contracts of trained employees, or electing not to renew existing contracts and face the burdensome expense of hiring and training new employees.

#### **RECOMMENDATIONS:**

- China should move rapidly toward full liberalization of its aviation relationship with the United States and other major trading partners to allow its international aviation market to flourish.
- Permit U.S. carriers to participate in airport fee development and to hire Chinese staff directly.

# Energy

Despite some progress achieved in opening China's oil sector, several market access barriers remain. Foreign investors are still highly restricted from trading in crude oil and petroleum products. China's imposition

of specific requirements for wharf size and product storage capacity and stockpiles makes it difficult for non-state traders to import petroleum products. In addition, China places strict regulatory controls on foreign investment in wholesale and retail operations of petroleum products. For example, U.S. companies need a Chinese Joint Venture (JV) partner to expand retail networks beyond 30 stations. 20 Restrictions on foreign participation in the wholesale market for processed and crude oil products are, according to China's WTO accession agreement, scheduled to be removed on December 11, 2006. However, the impact of this commitment is uncertain, as draft regulations propose high thresholds for foreign entrants, such as requirements for the number of retail stations and levels of storage capacity. It is also unclear if new regulations will mandate supply contracts with state-owned enterprises (SOEs) or allow foreign wholly-owned investment.

Given the importance of affordable reliable energy supplies globally, improved bilateral energy cooperation is in the commercial interests of both the United States and China.

#### **RECOMMENDATIONS:**

- Continue to engage in constructive dialogue with U.S. industry and circulate draft regulations for comment.
- Reduce burdensome regulatory controls on foreign investment in petroleum products at the wholesale and retail level.

 Clarify whether supply contracts with SOEs are mandatory and if foreign wholly-owned investment is allowed.

# **Express Delivery Services**

Express delivery services (EDS) are an essential component of an efficient economy. Restrictions on EDS inhibit the flow of goods through the economy, thereby making it less efficient and less competitive. U.S. express delivery companies operating in China enhance global trade by providing express and logistics services to companies throughout the world.

When China acceded to the WTO, it made unlimited General Agreement on Trade in Services (GATS) commitments for international and domestic courier services to operate outside of China Post's monopoly and broadly agreed not to "roll back" the liberal market-access rights that it had granted to foreign EDS suppliers. The Chamber is concerned, however, over repeated government efforts to restrict foreign firms' participation in China's EDS business, in direct violation of China's WTO commitments.

Specifically, the Chamber is concerned with China's postal reform plan, the eighth draft postal law, and its current postal entrustment system.

#### Postal Entrustment

Shortly after WTO accession, the Chinese government issued problematic measures altering the EDS licensing process and imposing new weight

20 This restriction on retailers was discussed in a broader context in this paper's section on "Distribution Services."

and rate restrictions. Following negotiations with the United States and other affected WTO members, China removed the weight and rate restriction but required foreign industry to submit an entrustment application to China Post. In turn, industry received assurances that entrustment would be a one-time only action and would not limit existing express delivery operations. These assurances were enshrined in regulations - Postal Document 556 of 2002 - jointly issued by the State Postal Bureau (SPB), MOFCOM and MII. The Chamber has highlighted this issue in its previous WTO implementation and JCCT reports.

However, these regulations were never implemented by the Chinese government. In fact, the SPB refuses to acknowledge their existence and has granted EDS firms' entrustment certificates for limited time periods only, most recently for the calendar year 2006. Moreover, although those same assurances and regulations state that firms would be granted one entrustment at the national level and the new branches would be "recorded" with the SPB, the SPB has directed companies to entrust locally.

The U.S. Chamber regards China's entrustment regime and the expansion of China Post's monopoly as a violation of China's WTO accession commitment not to "roll back" market access rights that had been granted to foreign EDS suppliers. China's actions violate GATS rules on Monopolies and Exclusive Service Suppliers (Article VIII) and Market Access (Article XVI). China's failure to publish measures affecting trade in services also violates GATS rules on transparency (Article III). In addition, China is violating GATS rules on domestic regulation (Article VI) by attempting to use licensing procedures (i.e., entrustment) to limit market access in committed sectors.

#### China Postal Draft Law

As a part of its postal reform plan, China has been working on draft postal legislation for several years, and it has purportedly produced an eighth draft of its postal law. Despite China's "notice and comment" commitment under its Protocol of Accession to the WTO and general transparency principles contained in GATS Article III, the Chinese government has not released a copy of the eighth draft for public comment. From communications with relevant authorities, however, the U.S. Chamber understands that the eighth draft of the postal law would create a new "licensing" system in addition to "entrustment," narrowly define "express delivery services" contrary to China's WTO commitments, include national treatment violations for domestic delivery services, and grant new, unsupervised powers of inspection and enforcement to a state postal regulatory agency.

The law would grant numerous competitive advantages to China Post relative to foreigninvested EDS firms. Specifically, the law would grant China Post a monopoly on letter delivery with two exceptions. The first would allow for international express letter delivery, subject to a separate set of regulations. The second exception would apply to letters and certain official documents of more than 150 grams. However, this second exception would not be available to foreign-invested EDS suppliers. This would explicitly prohibit foreign-invested enterprises from supplying domestic express letter delivery services in China. In addition to the clear violation of China's GATS market access commitments, the prohibition would discriminate against foreign EDS companies in violation of the GATS national treatment principle.

Furthermore, the draft would also grant new powers to the SPB to regulate the international express industry, including subjecting mergers and acquisitions of EDS companies' China operations to review and approval by the SPB. The Chamber also understands that the eighth draft includes several articles that give state-owned China Post and its subsidiaries and branches, including its express delivery arm Express Mail Service (EMS), many other competitive advantages over private companies. Advantages include: exemption from traffic regulations; expedited priority dispatch ensured by other transportation companies; preferential access to air, rail and sea transport; as well as potential tax breaks and subsidies. In addition, postal enterprises that engage in the competitive letter express business like EMS are not subject to the licensing requirements that other express delivery companies must follow.

Finally, the draft postal law would require EDS companies other than China Post to pay a tax to the Universal Postal Service Fund (UPSF). The details of how the tax would be levied and how the funds raised would be utilized are scheduled to be clarified through regulations that will be issued after implementation of the draft postal law. The U.S. Chamber is concerned that this measure would result in millions of dollars of lost revenue for U.S. companies and generally increase the cost of trade. At the same time, it is unclear how this fund would be used by China Post, including the possibility of subsidizing its express delivery services.

The provisions described above would not only impose an undue burden on foreign EDS firms inconsistent with China's WTO commitments. They would also inhibit the orderly growth and long-term sustainability of China's domestic and international logistics services industry, thereby

damaging the competitiveness of Chinese users of EDS and the long-term development of the Chinese economy.

At the April 2006 JCCT, China reiterated its commitment that the regulatory environment for EDS by foreign companies will not be negatively impacted by issuance of new rules, including the new postal law. The Chamber hopes that China will commit to work with industry and other concerned parties to draft a new postal law that is consistent with its WTO commitments and opening up the market.

Freight Forwarding and Logistical Services Revised international freight forwarding (IFF) rules issued on December 1, 2005 implement China's commitment to allow complete foreign ownership of IFF ventures, but regulations published by China's Civil Aviation Administration (CAAC) limit the ability of wholly foreign-owned IFF enterprises to provide the full range of such services. To book cargo space on an airline in China, an IFF enterprise must obtain an Air Freight Sales Agency License from the CAAC. There are two categories of air freight sales agency licenses: Class A, which allows the holder to book cargo space on international flights, and Class B, which allows the holder to book cargo space on domestic flights. Wholly foreign-owned enterprises (WFOEs) are unable to obtain these licenses, which are available only to domestic firms and joint ventures. This restriction is a violation of the full market access commitments in freight forwarding agency services (CPC 748 and 749) under "Services auxiliary to all modes of transport" that China made in its WTO accession.

The explanatory note to the Central Product Classification (CPC) system clearly and explicitly includes aircraft space brokerage services. China did not carve out or limit market access in the air

freight forwarding agency services category when it joined the WTO and should not, after the fact, act to limit market access in this area. Any exceptions, such as licensing requirements that limit market access, should have been explicitly scheduled in the services schedule included in the Protocol of Accession. In the absence of such exceptions, postaccession limitations in freight forwarding services are inconsistent with China's WTO commitments.

#### **RECOMMENDATIONS:**

### **Transparency**

- Provide public access, timely notice and adequate comment periods to industry on draft laws and regulations, including the draft postal reform plan, the eighth draft postal law, and any related implementing rules, regulations, policies or guidelines.
- Release the eighth draft postal law to the public for comments as required by the "notice and comment" commitment under China's Protocol of Accession to the WTO and general transparency principles contained in GATS Article III. Given China's legislative process, this should be done at the State Council Level, well before the law is pending before the National People's Congress.

### Revised Draft Postal Law and Freight Forwarding Licenses

- Adhere to the WTO commitment to open freight forwarding and courier services, without restrictions, to foreign-invested firms.
- Clearly and narrowly define postal monopoly through a weight and price limit, as is common in other jurisdictions.

- Refrain from imposing any new taxes, fees, or other charges on the EDS industry to support China Post or postal services.
- Retain MOFCOM as the regulator of the EDS industry and refrain from expanding regulatory powers and jurisdiction to the SPB.

### **Entrustment Agreement**

• Implement Postal Document 556 and the agreement reached at the 2003 JCCT meeting. Extend U.S. firms' entrustment licenses to the term of their MOFCOM-issued certificates and to a national scope. Provide for automatic renewal of their entrustment certificates consistent with China's WTO commitments.

#### **Financial Services**

Reform of China's capital markets is a priority for both China and the U.S. Chamber of Commerce. Our members have noted with great interest the 11th Five-Year Plan's call for the acceleration of financial structural reforms. As we understand it, this call for improvement reflects the seriousness in which policymakers are assessing the impact of financial services development on China's overall growth. China has achieved one of the largest shares of manufacturing GDP in the world, accounting for 46 percent of total output. Against this background, the financial services sector needs to make equal progress to ensure balanced growth. Chinese households have access to very few financial services, have few options for investment, and because their funds have to be placed with the state banks, have very low returns on their savings.

The Chamber recognizes China's success in implementing many WTO and GATS commitments in financial services, including the opening of health, group, and pension/annuity insurance markets to foreign participation and lifting geographic restrictions on the banking sector on or ahead of schedule. Progress has also been realized in improving transparency and in reducing procedural obstacles in licensing, although national treatment concerns remain. China has committed to loosen ownership limitations in the banking sector by December 2006, the end of the five-year WTO phase-in period for foreign banking services.

However, despite the progress realized and anticipated in the upcoming year, the Chamber remains concerned about discriminatory practices that disadvantage foreign companies in the banking and insurance sectors. As part of its ongoing capital market reforms, the Chamber urges China's leadership to do significantly more to open its financial services sector and undertake additional liberalization commitments, both through a more ambitious financial services offer under the Doha Round, as well as through other means. By expanding market access, China would also realize important benefits from having greater access to world-class financial services. Specific steps that China should take to bolster reform of its financial markets include:

- Permit foreign financial service firms to own 100 percent of the operations in which they invest, and to establish in the juridical form that best suits their business model (branch, subsidiary, joint venture);
- Treat foreign investors in a non-discriminatory manner and provide national treatment in all aspects of their business including the types of services they may provide and the clients they may serve, as well as licensing and other regulatory requirements;

- Permit foreign financial service firms to supply services cross-border to sophisticated consumers;
- Provide a transparent regulatory environment that includes administrative procedures that provide all market participants with effective notice and the opportunity to comment.

Improved WTO commitments by the Chinese government that reflect these principles will benefit China's economy and consumers through increased foreign investment—a prerequisite for providing China the expertise—transfer of technology, and technical assistance to reform and modernize its financial system, as identified and recommended in China's 11th Five-Year Plan.

### **Banking and Securities**

China's WTO accession commitments in the securities sector were an important first step toward liberalizing its capital markets. Although China has since opened some areas of its capital markets to foreign participation in ways not envisioned by its WTO accession commitments (for example, the Qualified Foreign Institutional Investor ("QFII") program), U.S. securities firms still face significant barriers to market access. The Chamber believes that China should take steps to implement reforms in two distinct areas in order to deepen and strengthen its capital markets.

The first, market access, comprises reform of restrictions (such as ownership limitations) that prevent foreign securities firms from obtaining full access to the Chinese market, impairing their ability to compete in an open manner with local firms. To date, foreign securities firms have either been limited to minority ownership (33 percent)

in joint ventures with limited licenses or have sought and achieved approvals involving minority ownership (less than 25 percent) accompanied by legally tenuous management control in restructured securities companies. Both approaches based on regulatory restrictions have proved to be less than successful in the eyes of the foreign investing institutions, as well as the local regulators. As the positive contributions of the joint venture fund management companies and QFII have demonstrated, greater foreign participation promotes the development of China's securities markets. Allowing foreign securities companies to participate meaningfully in the ownership and management of Chinese securities firms and to compete in a fair manner will raise industry and market standards.

In light of the highly regulated nature of the securities industry, the administration of the rules and regulations governing the market and market participants has a critical impact on the ability of securities firms to do business and compete. Progress in market reform (such as improved regulatory transparency and the ability to take full advantage of the greater flexibility contained in China's recently revised Company Law and Securities Law) not only complements, but facilitates advances in market access. The current barriers impede the development of China's financial capital markets, hampering the ability of China to create markets where entrepreneurs can access equity and debt capital, and investors—individual, financial, institutional, and pension funds—who can access products suited to their investment needs.

The U.S.-China Financial and Regulatory Dialogue recently established by the U.S. Treasury Department promises to serve as a forum in which significant progress can be made to advance China's financial

modernization, as well as reduce and eventually eliminate remaining discriminatory barriers.

#### **RECOMMENDATIONS:**

The Chamber believes that China would realize significant domestic and international benefits by implementing a package of liberalization in financial services that would:

- Permit foreign financial services firms to own 100 percent of the operations in which they invest, and to establish themselves in a juridical form that best suits their business model (branch, subsidiary, joint venture).
- Offer foreign investors non-discriminatory, national treatment in all aspects of their business including the types of services they may provide and the clients they may serve, as well as licensing and other regulatory requirements.
- Permit foreign financial service firms to supply services cross-border to sophisticated consumers.
- Yield a financial service regulatory and supervisory regime that is transparent and characterized by administrative procedures that provide all market participants with effective notice and the opportunity to comment.

### In addition, China should:

• Expedite the process of bank branch license review to enable U.S. banks seeking to expand to receive timely approvals and/or feedback on applications. In line with national treatment, allow foreign banks to open multiple bank branches in one year.

- Continue to "roll back" banking sector ownership restrictions. Specifically, remove the current 20 percent cap on foreign investment in Chinese banks.
- Ensure that all foreign banks are subject to the same regulations regardless of nationality.
- Eliminate all non-prudential (economic needs tests or quantitative limits on licenses) criteria that restrict ownership, operation, or juridical form of foreign financial institutions.
- Allow U.S. financial companies to own 100 percent of the equity in Chinese securities firms (permitting the acquisition of a full securities license and management control), consistent with the practice in all other emerging markets, through a transparent regulatory process.
- Continue to enhance communication through the U.S.-China Financial and Regulatory Dialogue.

#### **Insurance Services**

China has taken significant steps to implement laws and regulations consistent with its WTO commitments and to strengthen its rapidly growing insurance sector. The removal of geographic restrictions and most business scope restrictions has facilitated the growth of foreign insurance companies in China and strengthened the Chinese insurance market. The Chamber hopes that the Chinese government will continue to demonstrate its commitment to the basic principles of liberalization which includes: freedom of juridical form (branch, subsidiary, or joint venture), full ownership of investment, national treatment, and full transparency, as well as a strong outcome of the current WTO Doha Round negotiations, by submitting an improved offer to the insurance

sector. Such a revised offer would benefit China by opening its insurance market to further foreign investment of funds, giving it access to more advanced technologies and management methods, and would ultimately result in increased employment. Even in light of the currently stalled Doha process, the Chamber believes that China has much to gain from independently moving to liberalize its insurance sector.

The recent issuance of new insurance fund investment policies, rules governing cooperation between banking and insurance sectors, approvals of measures and regulations governing health insurance administration, and the appointment and qualification of directors and officers of insurance companies, are all encouraging developments.

These achievements reflect the Chinese government's recognition that a market-oriented insurance sector can help manage its rapidly growing economy and meet the needs of an increasingly finance-savvy public.

However, efforts are still needed in various areas of the industry, namely the desire to bring new products and services to the marketplace in a timely and efficient manner, the expansion of investment vehicles and channels, and data privacy and improved interdepartmental coordination. The Chinese government continues to authorize branch approvals on a consecutive basis for foreign firms and on a concurrent basis for Chinese firms. Because foreign firms can only secure license approvals one branch at a time, they are at a significant disadvantage in gaining access to national insurance markets. Revision and acceleration of the approval process, and increased regulatory transparency should thus be priorities during negotiations.

The insurance regulatory process as a whole is often insufficiently transparent. Advance notice of new and amendments to—existing laws and regulations and meaningful comment periods are not routinely observed. An important opportunity to improve on this situation lies in the current development of amendments to the Insurance Law. While the China Insurance Regulatory Commission (CIRC) has allowed companies to make comments on draft proposals, and should be strongly commended for doing so, the Chamber urges an ongoing consultation process as further refinements are drafted.

Most recently, when promulgating Regulations on the Administration of the Reinsurance Business (Reinsurance Regulations), the government did not provide sufficient time for foreign investors to provide comments to the regulator; these regulations were posted on-line in Chinese on October 31, 2005 with an effective date of December 1, 2005.

Additionally, CIRC is currently delaying the approval of foreign-owned companies' applications to convert from branches to subsidiaries. This seems to contravene its own regulation (Baojian Fa 45) which states that CIRC will review applications within two months. The 2005 Reinsurance Regulations discriminate against foreign reinsurance companies by requiring right of first refusal for 50 percent of each primary company's reinsurance program with domestic reinsurers. CIRC should clarify that a 100 percent owned subsidiary is considered an extension of the parent company's operation and therefore reinsurance ceded to the parent should be allowed.

Moreover, the Chamber is also concerned that the Reinsurance Regulations, which require direct insurers to first solicit reinsurance from two domestic insurers, prohibit direct insurers from

reinsuring more than 80 percent of any one risk, and prohibit direct insurers from reinsuring with affiliates except as approved by CIRC. This compromises a reinsurers' ability to provide expertise in underwriting, asset management, pricing, and risk management. Rules and regulations governing reinsurance must permit diversification and rely on increased transparency, accounting, audit, and disclosure standards to ensure best practices and prudent supervision.

China agreed in its WTO commitments to permit foreign insurers to provide pensions/annuities insurance within three years after accession. A private or enterprise pension system is a societal necessity as it provides additional employer-sponsored retirement income at no expense to the government. The industry is pleased that regulations have been introduced to establish a private pension industry and recommends that the Chinese government expand upon the existing regulations to foster the development of a private pension system. The licensing process for market operators should be as simple and transparent as possible.

The Chamber encourages government authorities to amend tax regulations to enable employers to make tax-deductible contributions to their employees' pension plans and to allow tax deferrals for individuals contributing to their own pension accounts. Direct and open dialogue between Chinese regulators, U.S. government officials, and U.S. industry continues to be necessary to ensure China's implementation of its fundamental WTO commitments, as well as fostering the overall healthy development of China's insurance sector. The Chamber appreciates CIRC's commitment to continuing the China-U.S. Insurance Dialogue and believes this dialogue can become a model of regulatory transparency in China.

#### **RECOMMENDATIONS:**

### **Branching**

- Grant consecutive, as opposed to concurrent, branch approvals to foreign insurers.
- Grant final approval of applications to transform operations from branches to subsidiaries within the two months after submission in accordance with CIRC's own regulation.
- Continue to remove geographic and business scope restrictions on foreign insurance companies.

### **Transparency**

- Provide timely notice and adequate comment periods to industry on draft rules and regulations, in particular regarding the pending draft amendments to the insurance law, prior to submission to the State Council or to the National Peoples Congress.
- Continue and enhance dialogue between CIRC and U.S. industry on a regular basis in order to promote continued development of the insurance sector.

#### Reinsurance

- Interpret the Reinsurance Regulations so as to permit the simultaneous solicitation of reinsurance offers from foreign reinsures.
- Eliminate the prohibitions on direct insurers from reinsuring more than 80 percent of any one risk or reinsuring with affiliates.
- Ensure that reinsurance regulations adhere to China's WTO national treatment commitments.

#### **Private Pensions and Tax Incentives**

- Establish a simple and transparent licensing process for private pension operators.
- Clarify licensing procedures through implementing rules for private pension and annuities.
- Amend tax regulations to provide incentives for both company and individual participants in private pension plans.

# Medical Technology

U.S. companies are world leaders in the production of medical technology products that improve and save lives. China is a large and expanding market—U.S. medical technology exports reached \$700 million last year—a 21 percent increase over 2004. However, U.S. exporters of medical devices continue to receive prejudicial treatment from Chinese regulatory agencies. An informal draft regulation written by China's National Development & Reform Commission (NDRC) in January 2006 proposed a medical technology monitoring system that would impose price controls and restrictions on profit-making.

This regulation, if implemented, would disproportionately impact U.S. manufacturers of innovative, implantable devices as the world leaders in this area. These restrictive price controls represent a misguided attempt to tackle problems such as irregularities in the distribution chain, increased health care spending, and corruption, which actually require broad-based reforms of the health care system. Additionally, the medical device industry continues to suffer from non-transparent and redundant processes concerning product testing and re-registration. These processes are unnecessary, costly, and limit market access. Recent JCCT

discussions have addressed the problem of duplicative conformity assessment and certification requirements by different Chinese agencies that result in higher testing costs and lengthy delays. While the April 2006 JCCT meeting took an important step forward in announcing that this redundancy would be eliminated, China's initial step in implementing this decision only addressed the product testing, ignoring the even more burdensome factory and border inspections.

Additionally, all medical devices—even those that have undergone no significant change since introduction or displayed any significant adverse events—are required to be re-registered every four years, a process that is identical to the initial registration process. This is unlike most major markets in the world, including the United States and Europe, where the re-registration processes are streamlined or automatic for devices that have undergone no significant change or displayed no significant adverse events while on the market.

Digital medical imaging instruments, one of the sixteen categories targeted by the June 28th, 2006 "State Council Opinions on Invigorating the Equipment Manufacturing Industry," represents one of the largest export categories of the U.S. medical device industry. If executed as written, the industrial policy implications of the new "Opinions" could have seriously detrimental effects on the foreign market for medical devices within China.

#### **RECOMMENDATIONS:**

 Adopt internationally-accepted standards for medical equipment, strive to minimize regulatory redundancy (particularly in product testing and

re-registration), and increase the transparency of such processes.

- Meet JCCT commitments in the area of redundant conformity assessment and certification requirements by eliminating redundant testing, factory inspection, and border inspection procedures for imported medical devices.
- Reconsider proposed regulations to implement price controls on medical devices and work with affected stakeholders to identify more appropriate and market-oriented ways to address health care spending concerns.
- Eliminate discrimination in favor of Chinese manufacturers of digital medical imaging devices including: enhanced financial support for domestic industries, increased scrutiny of foreign mergers and acquisitions, and increased tariffs on imported goods under the "State Council Opinions on Invigorating the Equipment Manufacturing Industry."

#### **Pharmaceuticals**

While China is a growing market for U.S. pharmaceutical companies, fundamental inefficiencies in China's health care system limit U.S. industry's commercial opportunities and restrict patient access to new medicines. For example, the current registration requirements for imported innovative New Chemical Entities entail a lengthy clinical evaluation process which results in the local population gaining access to new medicines at least four years after consumers in Europe or the United States. In the spirit of harmonization with both the European and U.S. based regulatory agencies and to provide faster

access to new medicines, the current regulatory system would benefit from benchmarking to other countries in the region that have adopted a more streamlined process while still ensuring the safety of their respective populations.

Strong IPR laws and accompanying enforcement are fundamental to the pharmaceutical industry's business model; they enable high levels of R&D investment and allow companies to bring new products to market. Despite China's efforts to reduce counterfeiting, the market for counterfeit goods continues to grow and is supplied by an increasingly sophisticated network of criminals. This trend undermines investor confidence and poses a serious public health risk. The U.S. pharmaceutical industry appreciates the previouslymentioned approval of the "Shanghai Initiative" by the MPS, which gives police agencies the authority to launch criminal investigations on their own volition when approached with leads on counterfeiting activity. This new scope of power has resulted in an important investigation, initiated in June 2006, of a ring dealing in fake drugs. This investigation is a significant first step toward a more efficient evidence-gathering and prosecution process and represents the first attempt to put the new policy into practice.

The U.S. pharmaceutical industry also continues to express its desire to collaborate with the Chinese government on constructive methodologies to manage growing health care costs. However, the current environment of price cuts within the hospital sector seems to be merely a short-run solution which can potentially stifle incentives for bringing innovative pharmaceuticals to this market. We suggest that innovative pharmaceuticals be considered as cost-effective solutions which may potentially reduce the overall cost-of-care

associated with the overuse of less-effective, if lower-cost, pharmaceutical products. Certain market barriers in China can only be addressed through long-term, comprehensive reform of the health care system. Other issues, however, such as pricing, patent and data protection, and IPR enforcement, can be effectively addressed through direct government-to-government dialogue.

#### **RECOMMENDATIONS:**

- Ensure all changes to pharmaceutical pricing policy are made in a transparent manner with input from all relevant stakeholders, including consultation with the U.S. government.
- Maintain the existing independent price review process for patent and innovative pharmaceutical products.
- Streamline, via clarification from the central government, the trading and distribution rights application process for foreign investors to avoid dual approval requirements from MOFCOM and the drug authority.
- Adopt implementation guidelines to clarify the scope and application process of products covered under data exclusivity regulations. 21
- Revise the definition of "counterfeit medicine" to include "deliberate mislabeling with respect to identity or source" in order to ensure the integrity of the medicine supply chain.
- Establish, publish, and manage a comprehensive database of patents related to drug applications to ensure transparency and timely notification of potential patent infringement.

- Eliminate the unreasonably high threshold for criminal IPR prosecution that a fake drug must "be harmful enough to endanger human health."
- Amend IPR regulations to prevent the direct or indirect supplying of bulk active pharmaceutical ingredients (API) to drug counterfeiters.
- Implement procedural safeguards to require licensing and certification of chemical manufacturers to produce, sell, distribute, and export API.
- Ensure faster access to innovative medicines by modifying the current price reimbursement process to increase transparency and encourage consistency across provinces.

### **Publications**

Upon accession to the WTO, China agreed to permit foreign-invested enterprises in China to import and distribute foreign books, newspapers, and magazines by 2004. However, China has failed to fully implement these commitments. In 2004, the General Administration of Press and Publications issued Administrative Measures on the Subscription of Imported Publications that restricted the distribution of imported publications to select state trading enterprises. In January 2005, the State Council issued Sectoral Guidelines Catalogue for Foreign Investment, which in contradiction to China's WTO commitments, continued to prohibit foreign importation of publications. China has since confirmed that foreign enterprises are permitted to

distribute publications in China, but it has not provided a justification for measures that restrict the distribution of imported publications to select state-owned enterprises (SOEs).

#### **RECOMMENDATIONS:**

- Adhere to WTO commitment to allow foreigninvested distributors to import foreign publications.
- Regulate the import and distribution of publications, including the administration of content restrictions in a transparent and nondiscriminatory manner.

# **Sound Recordings**

Chinese IPR infringements in the recording industry have become infamous in the global marketplace, with pirated goods being sold across the world. There are roughly 86 optical disc plants in China, and a considerable amount of production of DVDs and CDs consisting of infringing products destined for export. In 2005, it is estimated that the U.S. recording industry lost over \$200 million to pirate sales in China.

U.S. producers of sound recordings face many of the same problems confronting the AV sector and the Chamber hopes that China will remedy this distorted playing field as well. Lax IPR enforcement and significant market access barriers also make it very difficult for U.S. recording companies to develop this

<sup>21</sup> New data exclusivity implementing guidelines should explicitly indicate that the State Food and Drug Administration (SFDA) ensures the protection of the data package of innovative drugs as proprietary information and will not accept applications of generic drugs during the six-year exclusivity period, unless the generic producer provides a complete data package demonstrating the safety and efficacy of the drug.

market in China. U.S. record companies may not hold majority ownership in their investments in China. In addition, they are prevented from developing talent in China and from quickly getting legitimate products to market. The fact that U.S. record companies cannot "publish" or release a recording without permission of a state-owned company and cannot distribute or engage in retailing of their products makes it very difficult for legitimate companies to participate effectively in China's market. In addition, the Chinese government should address anomalies in the censorship clearance process, end the disparate treatment of foreign product (which are subject to Chinese government censorship whereas local producers may "self-censor").

China should improve the criminal enforcement system, deterring IPR violators by increasing criminal investigations and criminal penalties, and improve protection of electronic data by speeding up implementation of the World Intellectual Property Organization (WIPO) Internet Treaties. Decreasing barriers to entry and actively facilitating market access for U.S. firms will also help increase the competitiveness and legitimacy of China's domestic recording industry.

#### **RECOMMENDATIONS:**

- Permit majority foreign-owned record companies to develop, create, produce, publish, distribute, promote, and market sound recordings in China.
- End de facto censorship discrimination against foreign sound recordings.
- Criminally prosecute copyright pirates in China, including large optical disc manufacturing facilities.

### **Telecommunications Services**

The U.S. Chamber welcomed the announcement at the July 2005 JCCT meetings that China had agreed to a new dialogue to discuss capitalization requirements, resale services, and other issues affecting telecom market access as an encouraging sign. The U.S. Chamber has been encouraged further by announcements that, pursuant to the JCCT dialogue in April 2006, China has agreed to review whether it would reduce its extraordinarily high capitalization requirements associated with basic telecommunications licenses. Although the dialogue has begun, so far there have been few concrete developments that would materially open this important sector to the world. The United States must continue to urge China to afford U.S. companies an equivalent opportunity to participate in the Chinese market, as compared with the open opportunities that Chinese companies have to participate in the U.S. market.

Notwithstanding productive discussions at the JCCT in April, China has not taken meaningful action in the past year toward meeting its telecom commitments and continues to retain barriers to market entry. Under its WTO schedule, all geographic restrictions on value-added service (VAS) licenses were lifted in December 2003, followed by the availability of basic telecommunications service licenses in the major cities of Beijing, Shanghai, and Guangzhou in December 2004. However, there has been no rush by foreign carriers to enter the world's largest and fastest-growing telecom market because several barriers remain in the licensing process and general regulatory framework. The most important barriers are the requirement to enter a telecom joint venture with one of the existing state-owned telecommunications carriers, the excessive capitalization requirements for basic

service licenses, the uncommonly narrow scope of service permissible under a VAS license, the lengthy and labyrinthine license application process, and the limits on the level of foreign investment in a telecom licensee.

As an example of the valid concerns that foreign investors have with the regulatory framework in China, the Ministry of Information Industry (MII) drastically undermined the scope of a VAS license in early 2003 by issuing a telecom services classification catalogue—with no prior notice that eliminated or reclassified as a basic service the VAS applications of most importance to Chamber members and large Chinese enterprises (i.e. international Internet protocol-virtual private network (IP-VPN) services). In hand with limiting the effective scope of a VAS license, a basic service license remains out of practical reach due to excessively high capitalization requirements and the need to find a willing Chinese joint venture partner.

The U.S. Chamber was encouraged two years ago to learn that a draft version of a long-awaited Telecom Law was being circulated among government offices. The absence of legal stability and transparency that could be improved by such a law is a principal factor in the current unwillingness of potential foreign investors to commit capital in China.

The Chamber hopes that the Telecom Law will improve on the existing categories of basic and value-added services with a more objective, flexible, and transparent approach, such as the Type I (facilities-based) and Type II (non-facilitiesbased) classifications used in many other Asia Pacific economies. Such a change would be in conformance with international norms and would potentially accelerate service provider market entry, but only if foreign carriers are not officially marginalized into an artificial subcategory in the process. After this law takes effect, amendments are not to be expected, so it is essential that the market liberalization mechanisms impacting foreign investors be done right the first time. This need highlights the importance of public comment on the draft law, a procedure that has yet to be open to U.S. Chamber members.

With further liberalization, China can stimulate investment by foreign carriers and achieve its goal of building an equitable, fair, and competitive telecommunications market. This investment in the telecom sector, in turn, will support investment in China's broader economy.

#### **RECOMMENDATIONS:**

China can effectively foster investment by U.S. carriers and achieve its goal of building an equitable, fair, and competitive telecommunications market by taking further steps toward liberalization, including the following:

- Accelerate its work to separate the regulatory and commercial responsibilities of its telecoms regulator. MII presently does not meet the requirements of an independent regulator.
- Adopt the currently pending Telecom Law, including provisions that create an independent regulator, and overhaul the license regime to replace the current conservatively applied vertical service classification guidelines (i.e., basic/value-added) with more objective and transparent horizontal guidelines for Type I and Type II licenses that accelerate the market entry of service providers.

# U.S. Chamber of Commerce Report 2006

- Remove artificial market entry barriers both in the pending Telecom Law and in implementing regulations, including reduction of unreasonable and unnecessary capitalization requirements for foreign-invested telecom joint ventures.
- Grant equivalent national treatment to domestic and foreign telecom investors, consistent with its WTO commitments, and interpret WTO commitments as a floor, rather than a ceiling, for market liberalization efforts.
- Take steps to improve the transparency of regulatory processes. A major requirement is to make available for public comment a draft of the pending Telecom Law well before it is to take effect.
- Enforce the legality of telecoms' contractual agreements in a consistent and transparent manner. Doing so would greatly enhance international confidence in China's commitment to the rule of law in this sector.

- Remove the restriction requiring foreign telecom service providers to partner only with one of the six existing state-owned telecommunications providers when forming a telecom joint venture. Requiring foreign telecom service providers to partner with a company that may be a horizontal competitor of the joint venture could stifle competition.
- Relax or eliminate foreign direct investment restrictions, going beyond WTO commitment by allowing 100 percent foreign direct investment in telecommunications licensees.

# **Conclusion**

s China's WTO implementation process draws to a close, its role as a key member of the global trading community and its relationship with the United States has become more important than ever. Chinese officials are fond of citing the fact that China is the world's largest developing country while the United States is the largest developed country, yet this simple maxim does not capture the genuine complexity that is the U.S.-China economic relationship. In many ways, China's entry into the WTO and integration into the world's economy is among the most ambitious exercises of the global economic architecture that was inaugurated at Bretton Woods in 1944. China has benefited from the orderly system of trade guaranteed by that architecture.

As such, its adherence to the letter and spirit of WTO rules is a critical test. If China successfully implements its WTO commitments and continues the process of liberalization through economic reform, the WTO's mission to break down barriers to commerce and human development will score a striking success.

However, if China does not successfully implement its commitments and its economic liberalization stalls, the WTO's mission will be dealt a significant setback. For that reason, the Chamber carefully monitors all developments in China that affect its membership. We believe that U.S. business interests, the U.S. Congress, and the Administration must be vigilant against back-sliding by China on its WTO commitments. The 2006 Chamber Report on China's WTO Implementation was written with these goals in mind.

Since 2001, the Chamber has spent a great deal of energy and time analyzing changes in China's

business climate, calling attention to matters of concern and offering constructive suggestions to rectify problems. For the most part, the resulting annual reports, like this one, have noted a steadily improving bilateral trade relationship and an overall positive trend in China's moves to liberalize its markets. The Chamber recognizes the important strides that China has made in transforming its economic system, and continues to actively support these efforts. China has made remarkable progress toward fulfilling the promise of WTO membership; it has benefited from its WTO membership as manifested by its burgeoning share of global trade since December 2001. The Chamber's many initiatives, from the collaborative work on IPR in provinces throughout China, to the grassroots trade education seminars in 2nd- and 3rd-tier cities around the United States, speak to the profound level of the Chamber's commitment to nurture this relationship.

Despite this progress and these results, there are doubts about the future. Among China's trading partners, there remain concerns regarding China's implementation of certain commitments. This report has attempted to highlight areas of concern and suggest some remedies. There are also doubts in China, where some appear to be falling back on the false comfort of state planning and are questioning the value of further economic reform. This is troubling. The United States has encouraged China's increasing economic development through trade because it has been in the interests of both countries. If the citizens of China are to successfully achieve their true potential, the persistence of certain non-market oriented policies must be overcome. Equally important, if the relationship between the United States and China is to successfully achieve a strong and balanced

foundation, the economic policies and practices that threaten to further tilt the playing field and unsettle the commercial relationship must come to an end. These issues should concern not only members of the Chamber, but also those in China and the United States that believe in the promise of China as a true and responsible stakeholder in the global community.

Only through hard work and the continued efforts of U.S. and Chinese officials, along with that of those, like the Chamber, who support enhanced commercial ties with China, can the two countries continue to make progress on the important bilateral trade agenda. Much is at stake for both China and the United States in this process, and we all recognize and appreciate the efforts that officials in both countries are making to achieve successful outcomes.

Some in the United States and in China see protectionism as the answer to the challenge of globalization. The Chamber firmly rejects this view and believes that the maximum openness in trade of goods and services, investment, and flow of capital; free competition; and reliance on the market, are the best guarantors of continued economic growth in both countries. We call on the leaders of both countries to maintain open economic policies where they exist, and to develop them where they do not.

The U.S. Chamber stands ready and willing to work with U.S. and Chinese officials to develop constructive solutions to commercial issues in our bilateral relationship. We urge greater engagement and the continuation of results-oriented dialogues that resolve the issues outlined in this report. The importance to the United States of engaging the world's most populous nation in the rules-based system of international trade cannot be overstated.



U.S. Chamber of Commerce 1615 H Street, NW Washington, DC 20062-2000 202-463-5461 www.uschamber.com